SUPREME COURT, U. S.

FEB 29 1968

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JOINT APPENDIX TO BRIEFS

In the

SUPREME COURT OF THE UNITED STATES

October Term, 1967

Nos. 797, 804, 808, and 809

AMERICAN COMMERCIAL LINES, INC., ET AL., APPELLANTS

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY, ET AL.

AMERICAN TRUCKING ASSOCIATIONS, INC., ET AL.,
Appellants

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY, ET AL.

INTERSTATE COMMERCE COMMISSION, APPELLANT

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY, ET AL.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF KENTUCKY

FILED NOVEMBER 7, 1967
PROBABLE JURISDICTION NOTED JANUARY 15, 1968

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Plaintiffs

LOUISVILLE & NASHVILLE RAILROAD COMPANY
THE PENNSYLVANIA RAILROAD COMPANY*

Intervening Plaintiffs

THE ANN ARBOR RAILROAD COMPANY
THE ATCHISON, TOPEKA AND SANTA FE RAILWAY COMPANY
ATLANTA & WEST POINT RAIL ROAD COMPANY
ATLANTIC COAST LINE RAILROAD COMPANY
THE BALTIMORE & OHIO RAILROAD COMPANY
CENTRAL OF GEORGIA RAILWAY COMPANY
THE CHESAPEAKE & OHIO RAILWAY COMPANY
CHICAGO, BURLINGTON & QUINCY RAILROAD COMPANY
CHICAGO GREAT WESTERN RAILWAY COMPANY
CHICAGO, MILWAUKEE, ST. PAUL & PACIFIC RAILROAD COMPANY
CHICAGO & NORTH WESTERN RAILWAY COMPANY
CHICAGO, ROCK ISLAND & PACIFIC RAILROAD COMPANY
CLINCH FIELD RAILROAD COMPANY
THE COLORADO & SOUTHERN RAILWAY COMPANY
DETROIT, TOLEDO & IRONTON RAILROAD COMPANY
THE DENVER & RIO GRANDE WESTERN RAILROAD COMPANY
ELGIN, JOLIET & EASTERN RAILWAY COMPANY
ERIE-LACKAWANNA RAILROAD COMPANY
FORT WORTH & DENVER RAILWAY COMPANY
GEORGIA RAILROAD
GEORGIA SOUTHERN & FLORIDA RAILWAY COMPANY
GRAND TRUNK WESTERN RAILROAD COMPANY
GREAT NORTHERN RAILWAY COMPANY
GULF, MOBILE & OHIO RAILROAD COMPANY
ILLINOIS CENTRAL RAILROAD COMPANY
THE LEHIGH & HUDSON RIVER RAILWAY COMPANY
LEHIGH VALLEY RAILROAD COMPANY
MAINE CENTRAL RAILROAD COMPANY
MISSOURI-KANSAS-TEXAS RAILROAD COMPANY
MISSOURI PACIFIC RAILROAD COMPANY
THE NEW YORK CENTRAL RAILROAD COMPANY*

*Effective February 1, 1968, The New York Central Railroad Company was merged into The Pennsylvania Railroad Company, and the name of the surviving corporation was changed to Pennsylvania

THE NEW YORK, NEW HAVEN & HARTFORD RAILROAD COMPANY
NORFOLK SOUTHERN RAILWAY COMPANY
NORFOLK & WESTERN RAILWAY COMPANY
NORTHERN PACIFIC RAILWAY COMPANY
READING COMPANY
RICHMOND, FREDERICKSBURG & POTOMAC RAILROAD COMPANY
ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY
ST. LOUIS SOUTHWESTERN RAILWAY COMPANY
SEABOARD AIR LINE RAILROAD COMPANY
SOO LINE RAILROAD COMPANY
SOUTHERN PACIFIC COMPANY
SOUTHERN RAILWAY COMPANY
THE TEXAS & PACIFIC RAILWAY COMPANY
UNION PACIFIC RAILROAD COMPANY
WESTERN MARYLAND RAILWAY COMPANY
THE WESTERN PACIFIC RAILROAD COMPANY
THE WESTERN RAILWAY OF ALABAMA

v.

Defendants

UNITED STATES OF AMERICA, and
THE INTERSTATE COMMERCE COMMISSION
AMERICAN COMMERCIAL LINES, INC.
NATIONAL MOTOR FREIGHT TRAFFIC ASSOCIATION, INC.
WATERWAYS FREIGHT BUREAU
MISSISSIPPI VALLEY BARGE LINE COMPANY
OHIO RIVER COMPANY
UNION BARGE LINE CORPORATION
NATIONAL TANK TRUCK CARRIERS
AMERICAN TRUCKING ASSOCIATIONS, INC.
THE AMERICAN WATERWAYS OPERATORS, INC.

JUDGE GORDON

New York Central Transportation Company. This corporation designates itself, and is familiarly known, as Penn Central. See Pennsylvania Railroad Company - Merger - New York Central Railroad Company, 327 I.C.C. 475 (1966); 330 I.C.C. 328 (1967); Penn-Central Merger and N&W Inclusion Cases, 88 Supt. Ct. 602 (1968).

DOCKET ENTRIES

Jan. 4, 1966	Complaint filed. Summons issued and delivered to Marshal. Case referred to Judge Gordon for designation of 3-Judges.
Jan 6, 1966	Return on service of writ as to U.S. (Asst. U.S. atty, 3 copies to Atty. Gen. U.S. by mail) and on the Interstate Commerce Commission (registered mail), on 1-5-66.
Jan. 10, 1966	Received and filed "Designation" issued by Hon. Paul C. Weick, Chief Judge, U.S. Court of Appeals, 6th Circuit, January 7, 1966, designating the following Judges to hear and determine this action: Honorable Harry Phillips, Judge, U.S. Court of Appeals, Honorable Henry L. Brooks, Chief Judge, U.S. District Court, Western District of Kentucky; Honorable James F. Gordon, Judge, U.S. District Court, Western District of Kentucky.
Feb. 24, 1966	Motion for leave to intervene as a defendant filed by American Commercial Lines, Inc. with notice of hearing 3/4/66 at 2 pm. Order and Answer tendered.
Feb. 28, 1966	ORDER dated 2/28/66 permitting American Commercial Lines, Inc. to intervene as an additional party defendant and to file its answer to the complaint, and to otherwise participate in these proceedings. Copies to Attorneys Leigh, Stopher, Blackwell, Helmetag, Martin and Clark.
Feb. 28, 1966	ANSWER of intervening defendant American Commercial Lines, Inc. filed.
March 1, 1966	Motion for enlargement of time filed by U.S. Order tendered.
March 2, 1966	ORDER dated 3/1/66 that the time for filing the defendants' answer is extended from [illegible]/66 to and including 4/5/66. Copies to Attorn[illegible] Leigh, Stopher, Helmetag, Blackwell and Martin (U.S. Atty-Asst)
March 4, 1966	Motion of National Motor Freight Traffic Association, Inc. for leave to intervene as a defendant filed. ANSWER tendered.
March 4, 1966	Motion of Waterways Freight Bureau, Mississippi Valley Barge Line Co., Ohio River Company and

	Union Barge Line Corporation to intervene filed by Robert E. Webb. Order and Answer tendered.
March 10, 1966	ORDER dated 3/10/66 permitting intervention of Waterways Freight Bureau, Mississippi Valley Barge Line Company, Ohio River Company and Union Barge Line Corporation, and filing their ANSWER herein.
Apr. 4, 1966	Motion for extension of 45 days in which to file answer filed by U.S. Atty.
Apr. 5, 1966	Order signed by Judge Gordon 4-5-66 - time for filing answer extended to and including May 20, 1966. Copies to U.S. Atty., Elbert R. Leigh, Joseph E. Stopher, Carl Helmetag, Jr., R. Lee Blackwell, Eli H. Brown, III and Robert E. Webb.
Apr. 11, 1966	ORDER dated 4/11/66 that National Motor Freight Traffic Assn is permitted to intervene in this proceeding, file answer and otherwise participate fully. Copies to Attorneys Catlett, Freund, Rea, Marshall, Ginnane, Rivers, Ames, Leigh, Stopher, Helmetag and Blackwell.
Apr. 11, 1966	ANSWER of intervening defendant Natl Motor Freight Assn., Inc. filed.
May 20, 1966	Motion for enlargement of time filed by U.S. Attorney. Order tendered.
May 20, 1966	ORDER dated 5/20/66 that the time for filing defendants' answer is extended from May 20, 1966, to and including June 20, 1966. Copies to U.S. Attorney and Catlett & Amato, Rea, Cross, Knebel & Kinnaird, Harry C. Ames, Elbert R. Leigh, Joseph E. Stopher, Carl Helmetag, Jr., R. Lee Blackwell, Eli H. Brown, III and Robert E. Webb.
June 20, 1966	ANSWER of Interstate Commerce Commission filed. Filing confirmed on carbon of letter from Leonard S. Goodman, Asst. Gen. Counsel, I.C.C.
June 20, 1966	ANSWER of United States of America - filed, with certificate of service.
June 24, 1966	Motion to Intervene filed by National Truck Carriers, Inc., as deft. - filed. Answer and Order tendered.

July 5, 1966	Order signed by Judge Gordon 7/1/66 permitting National Tank Truck Carriers, Inc. to intervene as deft., with right to file an answer herein. Copies to Mr. Elbert R. Leigh, R. Lee Blackwell, Joseph E. Stopher, Carl Helmetag, Jr., Brown & Eldred, Laroe Winn & Moerman, George M. Catlett, F. G. Freund, Bryce Rea, Jr., Thomas M. Knebel, Robert E. Webb, Harry C. Ames, Nuel D. Belnap, Richard M. Freeman and Daniel J. Sweeney; Robert W. Ginane, Donald F. Turner, E. W. Rivers, 7/5/66.
July 5, 1966	Answer of Intervening Deft. Natl. Tank Truck Carriers, Inc. - filed.
July 12, 1966	Motion to enter the name of T. Randolph Buck, as additional counsel of record for the intervening defendant, American Commercial Lines, Inc. Order tendered.
July 13, 1966	ORDER dated 7/13/66 that the name of T. Randolph Buck, Esq., P.O. Box 610, Jeffersonville, Indiana, be added as additional counsel for the intervening American Commercial Lines, Inc. Copies to attorneys of record.
July 13, 1966	ORDER dated 7/13/66 that the time for filing shall be as follows: (1) Briefs for plaintiffs due 9/6/66, (2) Briefs for defendants due 10/17/66 and (3) Reply briefs of plaintiffs due 11/7/66. Copies to Attorneys Marshall, Katzenbach, Turner, Rivers, Wigger, Martin, Ginnane, Goodman, Ames, Webb, Brown, Martin, Clark, Laroe, Winn & Moerman, Catlett, Belnap, Belnap, Rea, Cross, Knebel & Kinnaird, Feund, Helmetag, Leigh and Buck.
Aug. 23, 1966	Motion of Ann Arbor Railroad Company and Certain Other Railroad Companies for Leave to Intervene in Support of Plaintiffs and Statement of Grounds in Support of Motion of The Ann Arbor Railroad Company and Certain Other Railroad Companies for Leave to Intervene in Support of Plaintiffs filed by R. Lee Blackwell. Order tendered.
Aug. 30, 1966	ORDER dated 8/30/66 that The Ann Arbor Railroad Company and certain other railroad companies are granted leave to intervene in support of plaintiffs, and to brief the issues and otherwise partici-

pate fully in this action. Copies to Attorneys: Elbert R. Leigh, R. Lee Blackwell, Carl Helmetag, Jr., Brown & Eldred, Laroe, Winn & Moerman, Geo. M. Catlett, F. G. Freund, Bryce Rea, Jr., Thos. M. Knebel, Robt. E. Webb, Harry C. Ames, Nuel D. Belnap, Robert W. Ginnane, Donald F. Turner, U.S. Attorney and Dept. of Justice.

Sep. 6, 1966 — Brief of the Railroads filed, with Appendix to Railroads Brief.

Sep. 6, 1966 — Brief for the United States filed with Certificate of Service.

Aug. 30, 1966* — Certain other railroads referred to in order entered 8/30/66: A. T. & SF RR Co., Atlanta and West Point RR Co., Atlantic Coast Line RR Co., B&O RR Co., Central of Ga. Rwy Co., C&O RR Co., Chi., Burl. & Quincy RR Co., Chi. Great Western Ry Co., Chi., Milwaukee, St. P. and Pacific RR Co., Chi. & North Western Ry Co., Chicago, Rock Island and Pacific RR Co., Clinchfield RR Co., Colorado & Southern RR Co., Detroit, Toledo & Ironton RR Co., Denver & Rio Grande Western RR Co., Elgin, Joliet & Eastern Ry Co., Erie-Lackawanna RR Co., Fort Worth & Denver Ry Co., Ga. RR, Ga. Southern & Fla. Ry Co., Grand Trunk Western RR Co., Great Northern Ry Co., Gulf, Mobile & Ohio RR Co., IC RR Co., Lehigh & Hudson River Ry Co., Lehigh Valley RR Co., Maine Central RR Co., Mo-Kansas-Texas RR Co., Mo. Pacific RR Co., NYC RR Co., NY., N. Haven & Hart. RR Co., Norfolk Southern Railway Co., Norfolk & Western Ry Co., Northern Pacific Ry Co., Reading Co., Richmond, Fredericksburg & Potomac RR Co., St. Louis, San Francisco Ry Co., Stl. Southwestern Ry Co., Seaboard Air Line RR Co., Soo Line RR Co., Southern Pacific Co., Southern Ry Co., Texas & Pacific Ry Co., Union Pacific RR Co., Western Maryland Ry Co., Western Pacific RR Co. and Western Ry of Ala.

Sep. 8, 1966 — Motion to substitute corrected brief for the United States filed by U.S. Attorney. Corrected brief tendered.

Sep. 8, 1966 — ORDER dated 9/8/66 setting hearing 1/23/67 at 9:30am. Copies to Attorneys.

Sep. 13, 1966	"Motion of American Trucking Associations, Inc. For Leave To Intervene In Support of Defendant, Interstate Commerce Commission" - filed by counsel for Movant.
Sep. 22, 1966	Order signed by Judge Gordon dated 9-22-66 that the time for filing briefs shall be changed as follows: 1. Briefs for the defendants and any parties in support of the Commission's order will be due on Thursday, November 17, 1966; 2. Reply briefs of the plaintiffs and any parties in support of them will be due on Wednesday, December 7, 1966. Copies mailed to Elbert R. Leigh, Joseph E. Stopher, R. Lee Blackwell, Carl Helmetag, Jr., Brown & Eldred, Laroe, Winn & Moerman, T. Randolph Buck, George M. Catlett, F. G. Freund, Bryce Rea, Jr., Thomas M. Knebel, Robert E. Webb, Harry C. Ames, Robert W. Ginnane, Leonard S. Goodman, Donald Turner, Robt. B. Hummel, John H. D. Wigger, Ernest W. Rivers, U.S. Atty; Bullitt, Dawson & Tarrant, Nuel D. Belnap, J. Raymond Clark.
Sep. 23, 1966	Order signed by Judge Gordon, dated 9-23-66 that on motion of American Trucking Associations, Inc., for leave to intervene in support of defendant, Interstate Commerce Commission, IT IS ORDERED that The American Trucking Associations, Inc., is granted leave to intervene in support of defendant, Interstate Commerce Commission, and to brief the issues and otherwise participate fully in this action. Copies to Thurgood Marshall, Nicholas B. Katzenback, Donald F. Turner, Ernest W. Rivers, John H. D. Wigger, Robt. W. Ginnane, Leonard S. Goodman, Harry C. Ames, Robert E. Webb, Eli H. Brown, R. Lee Blackwell, J. Raymond Clark, Laroe, Winn & Moerman, Nuel D. Belnap, Carl Helmetag, Jr., Elbert R. Leigh, T. Randolph Buck, Harry J. Breithaup, Jr., Joseph E. Stopher, E. G. Freund, Bryce Rea, Jr., Thos. Knebel, Robt. B. Hummel, Bullitt, Dawson & Tarrant.
Sep. 23, 1966	ANSWER of American Trucking Assns., Inc. filed.

Oct. 7, 1966	Motion of the American Waterways Operators, Inc. to intervene as defendant filed with Memorandum of points and authorities in support of motion to intervene. Order and Answer tendered.
Oct. 10, 1966	ORDER dated 10/10/66 that The American Waterways Operators, Inc. is permitted to intervene as a party defendant and to file its answer to the complaint, and otherwise participate in these proceedings. Copies to Attorneys Stopher, ICC, Buck, Leigh, Blackwell, Helmetag, Atty-Gen., U.S. Atty, Brown, Clark, Catlett, Freund, Knebel, Webb, Ames Smith and Layne.
Oct. 10, 1966	ANSWER of intervening defendant The American Waterways Operators, Inc. filed.
Oct. 13, 1966	ORDER dated 10/13/66 that motion of U.S. to file corrected brief in place of brief filed 9/6/66 SUSTAINED. Copies to all parties of record.
Oct. 13, 1966	Corrected brief filed by U.S.
Oct. 14, 1966	Motion of Waterways Freight Bureau, Mississippi Valley Barge Line Co., Ohio River Co. and Union Barge Line Corp. for order postponing due date of briefs; proposed order tendered.
Nov. 14, 1966	Order signed by Judge Gordon 11/14/66 that time for filing briefs to be changed as follows: 1. Briefs for defts. and any parties in support of the Commission's order will be due on Mon. Nov. 28, 1966; and 2. Reply briefs of pffs. and any parties in support of them will be due on Mon. Dec. 19, 1966. Copies to counsel of record mailed 11/14/66.
Nov. 23 1966	Brief for The American Waterways Operators, Inc., intervening defendant, filed.
Nov. 25, 1966	Brief on behalf of Mississippi Valley Barge Line Company; Ohio River Company; Union Barge Line Corporation; and Waterways Freight Bureau; Protestants before the Interstate Commerce Commission and intervening defendants herein - filed.
Nov. 25, 1966	Brief on behalf of American Commercial Lines, Inc., Intervening Defendant, filed.

Nov. 28, 1966	Brief of the Interstate Commerce Commission filed.
Nov. 28, 1966	Brief of American Trucking Associations, Inc., National Motor Freight Traffic Assn., Inc. and National Tank Truck Carriers, Inc. - filed.
Dec. 19, 1966	Reply Brief for the United States filed with Certificate of Service.
Dec. 20, 1966	Reply Brief of the Railroads filed.
Jan. 23, 1967	Interstate Comm. Comm. case No. 28190 filed by Mr. Carl Helmetag, Jr., ICC - investigation and suspension docket No. 7656 - also filed.
Jan. 25, 1967	ORDER signed by Judge Gordon dated 1/23/67 that the Court having heard oral arguments will take the matter under advisement and all parties submit proposed orders within 30 days of this order. Copies to Elbert R. Leigh, Joseph E. Stopher, Carl Helmetag, Jr., R. Lee Blackwell, Hon. Thurgood Marshall, Donald F. Turner, John J. D. Wigger, Robert K. Johnson, Leonel Kestenbaum, Ernest V. Rivers, Wm. B. Martin, Robert W. Ginnane, Leonard S. Goodman, Eli H. Brown, Boyce F. Martin, Jr., T. Randolph Buck, J. Raymond Clark, Geo. M. Catlett, F. G. Freund, Bryce Rae, Jr., Thomas M. Knebel, Robert E. Webb, Harry C. Ames, S. Russell Smith, and A. Alvis Layne.
Feb. 1, 1967	Transcript of proceedings held 1/23/67 filed by C. L. Sterling, Court Reporter.
Feb. 6, 1967	Filed by Court Reporter: Certified copies of (1) Schedule filed with ICC 9/11/64-Supplement 65 to Trunk-Line-Central Territory Railroads Tariff Bureau Etc. (2) Pleadings before ICC in I&S No. 8038, Ingot Molds, Pa., to Steelton, Ky. (3) Transcript of stenographer's notes (same case).
Feb. 23, 1967	Proposed order of the Railroads and the United States tendered with the Certificate of Service filed. Copies forwarded to Judge Phillips, Judge Brooks and Judge Gordon.
Feb. 23, 1967	Proposed findings of fact and conclusions of law filed by I.C.C. and Intervening Defendants.

May 15, 1967 — Judgment signed by Judges Phillips, Brooks and Gordon dated May 15, 1967 - Court having concluded in its opinion (unsigned opinion attached to judgment) that plaintiffs are entitled to judgment, Ordered, adjudged and decreed that the report and order of the Interstate Commerce Commission, entered 12-2-65, be set aside and the ICC hereby enjoined from enforcing it with prejudice. Matter remanded to Commission for reconsideration and such further action as the Commission may deem appropriate, not inconsistent with the opinion this day rendered by this court. Copies of Judgment and Opinion mailed to all counsel of record.

July 12, 1967 — Notice of appeal by American Waterways Operators Inc., to U.S. Supreme Court - filed. Copies of Notice of Appeal mailed 7/12/67 to: Hon. Thurgood Marshall, Solicitor General of U.S.; Hon. Ramsey Clark, Attorney General of U.S.; Hon. Ernest W. Rivers, U.S. Attorney, Robert W. Ginnane, General Counsel, Interstate Commerce Comm.; Ames, Hill & Ames; Robert E. Webb; Joseph E. Stopher; R. Lee Blackwell; Eli H. Brown, III; Royce F. Martin, Jr.; J. Raymond Clark; LaRoe, Winn & Moerman; George M. Catlett; Rea, Cross & Knebel; F. G. Feund; Carl Helmetag, Jr.; Elbert R. Leigh; T. Randolph Buck; Belnap, Spencer, Hardy & Freeman; James A. Bistline; Stanfield Johnson; J. Edgar McDonald; Thormund A. Miller; Donald L. Turkal; and Gregory S. Prince.

July 13, 1967 — Notice of appeal by Interstate Commerce Commission to U.S. Supreme Court - filed. Copies of Notice of Appeal mailed 7/13/67 to: Hon. Thurgood Marshall, Solicitor Gen. of U.S.; Hon. Ramsey Clark, Attorney General of U.S.; Hon. Ernest W. Rivers, U.S. Attorney; Robert Ginnane, General Counsel, Interstate Commerce Comm.; Ames, Hill & Ames; Robert E. Webb; Joseph E. Stopher; R. Lee Blackwell; Eli H. Brown, III; Royce F. Martin, Jr.; J. Raymond Clark; LaRoe, Winn & Moerman; George M. Catlett; Rea, Cross & Knebel; F. G. Feund; Carl Helmetag, Jr.; Elbert R. Leigh; T. Randolph Buck; Bel-

	nap, Spencer, Hardy & Freeman; James A. Bistline; Stanfield Johnson; J. Edgar McDonald; Thormund A. Miller; Donald L. Turkal; and Gregory S. Prince and S. Russell Smith.
July 13, 1967	Notice of appeal by American Commercial Lines, Inc., Mississippi Valley Barge Line Company, Ohio River Company, Union Barge Line Corporation and American Waterways Freight Bureau to U.S. Supreme Court - filed. Copies of Notice of Appeal mailed 7/13/67 to: Hon. Thurgood Marshall, Solicitor Gen. of U.S.; Hon. Ramsey Clark, Attorney General of U.S.; Hon. Ernest W. Rivers, U.S. Attorney; Robert Ginnane, General Counsel, Interstate Commerce Comm.; Ames, Hill & Ames; Robert E. Webb; Joseph E. Stopher; R. Lee Blackwell; Eli H. Brown, III; Royce F. Martin, Jr.; J. Raymond Clark; LaRoe, Winn & Moerman; George M. Catlett; Rea, Cross & Knebel; F. G. Feund; Carl Helmetag, Jr.; Elbert R. Leigh; T. Randolph Buck; Belnap, Spencer, Hardy and Freeman; James A. Bistline; Stanfield Johnson; J. Edgar McDonald; Thormund A. Miller; Donal L. Turkal; Gregory S. Prince; and S. Russell Smith.
July 14, 1967	Notice of appeal by American Trucking Associations, Inc., National Motor Freight Traffic Association, Inc., and National Tank Truck Carriers, Inc., to U.S. Supreme Court - filed.
July 17, 1967	Copies of Notice of Appeal mailed 7/17/67 to: Hon. Thurgood Marshall, Solicitor Gen. Of U.S.; Hon. Ramsey Clark, Attorney General of U.S.; Hon. Ernest W. Rivers, U.S. Attorney; Robert Ginnane, General Counsel, Interstate Commerce Comm.; Ames, Hill & Ames; Robert E. Webb; Joseph E. Stopher; R. Lee Blackwell; Eli H. Brown, III; Royce F. Martin, Jr.; J. Raymond Clark; LaRoe, Winn & Moerman; George M. Catlett; Rea, Cross & Knebel; F. G. Feund; Carl Helmetag, Jr.; Elbert R. Leigh; T. Randolph Buck; Belnap, Spencer, Hardy & Freeman; James A. Bistline; Stanfield Johnson; J. Edgar Mc Donald; Thormund A. Miller; Donald L. Turkal; Gregory S. Prince; and S. Russell Smith.

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF KENTUCKY
AT LOUISVILLE

Civil Action No. 5227

LOUISVILLE AND NASHVILLE RAILROAD COMPANY and
THE PENNSYLVANIA RAILROAD COMPANY,
Plaintiffs

v.

UNITED STATES OF AMERICA and
INTERSTATE COMMERCE COMMISSION,
Defendants.

Before the Honorable Harry Phillips, Circuit Judge, and the Honorable Henry L. Brooks and the Honorable James F. Gordon, District Judges.

OPINION

Gordon, District Judge. This suit was brought before this Three-Judge Court, under the provisions of 28 U.S.C. §§ 1336, 2284, 2321-2325, by the Louisville and Nashville Railroad Company and The Pennsylvania Railroad Company to enjoin, annul and set aside an order of the Interstate Commerce Commission in Investigation and Suspension Docket No. 8038, *Ingot Molds, Pa. to Steelton, Ky.*, 326 I.C.C. 77 (1965). As required by law, the United States of America was named a defendant, as was the Interstate Commerce Commission.

Some 48 railroads were permitted to intervene as additional plaintiffs in support of the principal plaintiff railroads. Interested and requesting barge lines, truck carriers and related associations were permitted to inter-

vene in support of the defendant, Interstate Commerce Commission.

The United States of America, admitting that "the Order of the Interstate Commerce Commission is invalid", was, for purposes of brief and oral argument, treated as an additional plaintiff.

On January 23, 1967, oral argument was heard before this Court.

In 1953, the Green River Steel Corporation began purchasing ingot molds and stools from the Shenango Penn Mold Company at Neville Island, Pittsburgh, Pa. The shipper's plant at Neville Island is served by the Pennsylvania Railroad in connection with a short-line railroad, and the receiver's plant at Steelton, Kentucky is served directly by the Louisville and Nashville Railroad. Prior to 1965 the barge-truck route received substantially all of this traffic because its charges were below rail charges. The then and present charge for movement by barge-truck being $5.11 per gross ton, minimum 600 gross tons, and the railroad charge then being $11.86 per ton, subject to a carload minimum of 100,000 pounds.

With the stated purpose of enabling them to compete for this traffic, the respondent railroads published, effective December 1, 1963, a reduced rate on ingot molds, from Neville Island and Pittsburgh, Pa., to Steelton, Ky., of $5.11 per ton, when moved in single shipments of not less than 600 gross tons, minimum weight 112,000 pounds per car (12 or fewer cars) on one bill of lading, from one consignor at one origin to one consignee at one destination, with delivery to the originating railroad to be completed on one day. Consignee testimony indicates that if the railroads are to participate substantially in the movement, it will be necessary to have a rail rate not exceeding the total cost to the consignee of handling the ingot molds via barge-motor service.

The Commission found that the railroads' so-called out-of-pocket costs of transporting the ingot molds traffic, when computed by its own Rail Form A formula, would be $4.689 per ton, and substantially less if return on investment were eliminated. Since the reduced rail rate exceeded such costs by 42.1 cents, the Commission found that the rate would be compensatory. The Commission further found that the lower rail rate of $5.11, by attracting greater volume, would produce greater revenues in excess of out-of-pocket costs than would the higher rail rate of $11.86, which formerly had attracted only minimal tonnage, and also that "the railroad out-of-pocket costs are lower than the barge-motor lines' variable (i.e., out-of-pocket) costs". Further, that the railroads' "fully-distributed" costs amounted to $7.594 and the barge-truck "fully-distributed" costs were $5.196. These "fully-distributed" cost calculations were made by adding to the expenses incurred in handling the ingot molds traffic statistical apportionments of the respective modes' constant costs. The constant costs are expenses which are not related or traceable to the handling of any particular item of traffic.

Upon protest of the barge lines, the reduced rail rate was suspended and placed under investigation by the Commission. By voluntary agreement, the suspension period was extended until the matter was determined by Division 2. After Division 2, on February 17, 1965, 323 I.C.C. 758, found the rate to be lawful, the railroads made it effective on March 19, 1965. This rate has remained in effect since that time. Subsequently, December 2, 1965, the entire Commission in its report and order found the rate to be unlawful and ordered it cancelled, 326 I.C.C. 77, but this order of the Commission has been stayed pending consideration of the situation by this Court.

The Commission held that the determination of which mode had the inherent advantage of lower costs in han-

dling the involved ingot molds traffic should be based upon a comparison of the "fully-distributed" costs of the two modes. Upon this comparison, it found that the barge-truck route possessed the advantage of lower costs in transporting ingot molds. It further decided that the reduced rail rate unlawfully "impinged upon the ability of the barge-truck mode competitively to assert its inherent cost advantage" because the reduced rate was below the level of the "fully-distributed" costs of the barge-truck route. The Commission established the "fully-distributed" costs of the barge-truck route ($5.196) as the floor for the reduced rail rate, although the barge-truck rate of $5.11 was below this level.

The principal statutory provision governing this controversy is Section 15a(3) of the Interstate Commerce Act (49 U.S.C. § 15a(3)), which came into the Act by the enactment of the Transportation Act of 1958, 72 Stat. 572. That Section reads:

> In a proceeding involving competition between carriers of different modes of transportation subject to this Act, the Commission, in determining whether a rate is lower than a reasonable minimum rate, shall consider the facts and circumstances attending the movement of the traffic by the carrier or carriers to which the rate is applicable. Rates of a carrier shall not be held up to a particular level to protect the traffic of any other mode of transportation, giving due consideration to the objectives of the national transportation policy declared in this Act.

The National Transportation Policy referred to is the preamble to the Interstate Commerce Act and provides guidance for interpreting the various sections of the Act. In its present form, it became part of the Interstate Commerce Act by the enactment of the Transportation Act of 1940, 54 Stat. 898. It reads:

> It is hereby declared to be the national transportation policy of the Congress to provide for fair and impartial regulation of all modes of transportation subject to the provisions of this Act, so administered as to recognize and preserve the inherent advantages of each; to promote safe, adequate, economical, and efficient service and foster sound economic conditions in transportation and among the several carriers; to encourage the establishment and maintenance of reasonable charges for transportation services, without unjust discriminations, undue preferences or advantages, or unfair or destructive competitive practices; to cooperate with the several States and the duly authorized officials thereof; and to encourage fair wages and equitable working conditions;—all to the end of developing, coordinating and preserving a national transportation system by water, highway and rail, as well as other means, adequate to meet the needs of the commerce of the United States, of the Postal Service, and of the national defense. All of the provisions of this Act shall be administered and enforced with a view to carrying out the above declaration of policy.

Jurisdiction of the subject matter and venue of this action in this Court is conceded by the parties.

Under Section 10(e) of the Administrative Procedure Act, 5 U.S.C. § 1009, the scope of our review of the Commission's order is limited to a determination of whether the order is arbitrary or not in accordance with the law, and whether the Commission's findings are supported by substantial evidence. An order is arbitrary within the meaning of the Administrative Procedure Act if it lacks a stated rational basis. See *Gilbertsville Trucking Co.* v. *United States*, 371 U.S. 115, 126 (1962); *Burlington Truck Lines* v. *United States*, 371 U.S. 156, 167-68 (1962); *Eastern Central Motor Carriers Ass'n* v. *United States*, 239 F.Supp. 591, 594 (D. D.C. 1965). It is not in

accordance with the law within the meaning of Section 10(e) if it is based upon an erroneous interpretation or misapplication of relevant statutory provisions. See *St. Louis-San Francisco Ry. Co.* v. *United States*, 207 F.Supp. 293, 295 (E.D. Mo. 1962); *Missouri Pacific R.R. Co.* v. *United States*, 203 F.Supp. 629, 631-33 (E.D. Mo. 1962). While the determinations of an administrative agency are normally entitled to considerable deference upon review, *cf. East Texas Lines* v. *Frozen Food Express*, 351 U.S. 49, 54 (1956), and orders of the Commission which satisfy the requirements stated above are not to be disturbed on review even though the Court might reach a different result on the record, "it is not the function of a court sitting in such review merely to apply a rubber stamp of approval regardless of whether or not the criteria for affirmance are established by the record". *Cincinnati, N.O. & T.P. Ry. Co.* v. *United States*, 229 F.Supp. 572, 575 (S.D. Ohio 1964), vacated *sub. nom. Arrow Transp. Co.* v. *Cincinnati, N.O. & T.P. Ry. Co.*, 379 U.S. 642 (1965).

We have concluded that the Commission's order must be set aside, *first*, because it lacks a rational basis and thus is arbitrary and, *second*, because it is inconsistent with the objectives and purposes of Congress in enacting Section 15a(3) of the Interstate Commerce Act, 49 U.S.C. § 15a(3), and thus is not in accordance with law.

In disapproving the proposed reduced rate of the railroads, the Commission appears to us to be plainly holding up the railroad rate "to protect the traffic" of another mode. It argues, however, that the National Transportation Policy, to which it is commanded to give "due consideration" by the same provision, compels this result. It relies specifically on the requirement that the Act be administered to "recognize and preserve the inherent advantages of each (mode of transportation)".

In *Interstate Commerce Comm'n* v. *New York, N.H. & H.R.R. Co.*, 372 U.S. 744, 760-61 (1963) (referred to hereafter as *New Haven*), the Supreme Court specifically left open the question which is raised in this proceeding. The Court said:

> It is not for us to make this determination at this stage, or to decide in advance precisely how either carrier's inherent advantages should be measured or protected. It may be, for example, that neither a comparison of 'out-of-pocket' nor a comparison of 'fully-distributed' costs, as those terms are defined by the Commission, is the appropriate method of deciding which of two competing modes has the cost advantage on a given movement . . . . These and other similar questions should be left for initial resolution to the Commission's informed judgment. (372 U.S. at 760-61)

This is the first case following *New Haven* in which a court has been called upon to review a determination by the Commission of how the inherent advantages of competing modes of transportation should be recognized or preserved. Since there are no directly controlling court precedents, it is for this court to determine whether the Commission's order properly implements the objectives and purposes of the Congress in enacting Section 15a(3).

We hold, first, that the Commission has failed to state a rational basis to support its conclusion that the "fully-distributed" costs of the two competing modes must be compared to determine which mode has an inherent cost advantage. In support of this conclusion, the Commission states:

> We do not agree with respondents' arguments that fully distributed costs are an inappropriate or inadequate measure of the inherent cost advantages of competing regulated carriers. That is not to say that fully distributed costs should set the floor for

transportation prices. In the setting of particular rates, as where competition from unregulated carriers compels, a carrier should be allowed to set its rates below fully distributed costs. However, merely because a carrier is able, without incurring an out-of-pocket loss, to handle certain traffic at rates below fully distributed costs, and perhaps by diverting sufficient tonnage from its regulated competitors to maximize thereby the contribution that such traffic would make to its overhead, *does not necessarily mean that the carrier is the more efficient of the two.* Carriers, such as the railroad respondents, do not, in the circumstances here present, possess an inherent cost advantage within the context of the national transportation policy which the Commission is obligated to recognize and preserve. (326 I.C.C. at 82) (Emphasis added)

The language we have just quoted contains the only statement in the Commission's opinion in which it refers to the question of the relative efficiency of the competing carriers in carrying this traffic. This question is one of great importance in view of the Commission's obligation, declared in the National Transportation Policy and the ratemaking provisions of the Act, to promote efficient and economical use of transportation resources and the establishment of rates which are as low as possible. The importance of these considerations has been underscored repeatedly by the courts. Thus, the Supreme Court in *New Haven* emphasized the Congressional policy to promote "hard competition" (372 U.S. at 759). In *St. Louis-San Francisco Ry. Co.* v. *United States*, 207 F.Supp. 293, 298-99 (E.D. Mo. 1962), the court emphasized the obligation of the Commission to consider "the need, in the public interest, of adequate and efficient transportation service at the lowest cost consistent with the furnishing of such service".

The Commission states that: "Merely because a carrier is able, without incurring an out-of-pocket loss, to handle

certain traffic at rates below fully-distributed costs and by gaining added traffic maximize the contribution which such traffic makes to its overhead, does not necessarily mean that the carrier is the more efficient of the two" (326 I.C.C. at 82). Are we not entitled to ask *in what circumstances*, if any, would the carrier with lower out-of-pocket costs be *less efficient*? Are we not entitled to some explanation *why the standard* chosen by the Commission *measures* which carrier is more efficient in providing the service here involved? On the basis of the Commission's report, we are left completely in the dark on these matters.

The Commission's failure to explain how its approach for recognizing and preserving the inherent advantages of the different modes of transportation promotes the most efficient and economical use of transportation resources is particularly wanting since the record before it contained testimony addressed to this question; though the Commission was not bound to accept same, such did at least, we think, make it necessary for the Commission to set forth adequate reasons to support its own approach. Such reasons are lacking in the Commission's report.

For example, the record indicates that one of the constant expenses which is included in the railroads' "fully-distributed" costs is an allocated share of the deficits (very substantial in amount) incurred by the railroads in providing passenger and less-than-carload services.

The barge lines and motor freight carriers do not provide passenger services. Is it unrealistic in comparing the relative efficiency of the two modes, to include as a part of the railroads' costs these deficits? Is it equally unrealistic in determining which mode is more efficient, to include any other constant expenses in the costs being compared, since these expenses, like the passenger deficits,

are not related to furnishing the particular service? The Commission no where comes to grips with these questions, nor does it set forth its own analysis in making its determination.

In its statement supporting its conclusion hereinabove, the Commission also says that, "In the setting of particular rates, as where competition from unregulated carriers compels, a carrier should be allowed to set its rates below fully distributed costs." This statement reflects the Commission's use of an out-of-pocket cost comparison to determine which of the competing modes has an inherent advantage in situations where there is substantial competition from unregulated carriers. In such situations, the Commission finds a reduction lawful if it exceeds the proponent carrier's out-of-pocket costs. See *Grain in Multiple-Car Shipments—River Crossings to the South*, 321 I.C.C. 582 (1963).

The Commission leaves unexplained its use of different pricing floors *depending upon whether a reduced rate* is intended to meet *regulated* or *unregulated* competition.

We believe that the reasons given by the Commission in the Southern Grain case to support its conclusion that the public interest is fostered by permitting a regulated mode to compete with nonregulated lawful carriers, by offering reduced rates which exceed out-of-pocket costs, logically would seem to apply equally where competition is between two competing regulated modes.

Likewise, we reject as adequate support for the Commission's decision here, its finding that since railroad out-of-pocket costs are lower than barge-motor line variable costs, the former could wage a longer rate battle than the latter, with the Commission powerless to intercede and halt such devastation, all to the prejudice of recognition and preservation of inherent advantage as contemplated

by national policy. The Commission's power to disapprove non-compensatory rates and prevent destructive competition is firmly established. Such an argument that the consequence of a rate reduction below fully distributed costs would leave the Commission powerless has heretofore been rejected. *Missouri Pacific R.R. Co.* v. *United States*, 203 F.Supp. 629, 635 (E.D. Mo. 1962).

Citations by the Commission of several prior decisions in which it compared "fully-distributed" costs to determine which mode had an inherent advantage contain no further explanation to support such a standard, although not determinative, we note that the Commission has not consistently employed a "fully-distributed" cost standard. For example, in one recent case, *Roasted Coffee and Coffee Extracts From Texas Gulf Ports to Texas*, 314 I.C.C. 675, 680 (1961), the Commission says, "It would be inconsistent with the national transportation policy to prohibit the respondents from establishing competitively necessary rates which are shown to be compensatory." And see *Paint and Related Articles in Official Territory*, 308 I.C.C. 439 (1959); *Fresh Meats, Transcontinental, Westbound*, 309 I.C.C. 529, 544 (1960); *Prue Motor Transp. Inc.* v. *Boston & Maine R.R.*, 316 I.C.C. 299, 302 (1962). *Cf. Iron Ore, Cleveland, Ohio to Ohio and Pennsylvania*, 323 I.C.C. 746, 754 (1965), complaint dismissed, *Baltimore & Ohio R.R. Co.* v. *United States*, 249 F.Supp. 712 (W.D. Pa. 1965), aff'd *per curiam* 385 U.S. 3 (1966).

The Commission also relies upon the decision of the Supreme Court in *New Haven*. We have previously pointed out that the Supreme Court there specifically left open for later decision the question which is presented in this proceeding, after making it clear that this question was not before it (372 U.S. at 749-50). As we read the Supreme Court's opinion, it held that the Commission

cannot, under Section 15a(3) and the National Transportation Policy, find unlawful the reduced rate of one mode merely because it would divert some or even all of the traffic from a competing mode. As the Court said:

> If there is one fact that stands out in bold relief in the legislative history of § 15a(3), it is that Congress did not regard the setting of a rate at a particular level as constituting an unfair or destructive competitive practice simply because that rate would divert some or all of the traffic from a competing mode. (372 U.S. at 759)

The Court also said that a reduced compensatory rate should not be found unlawful unless this is necessary to preserve the inherent advantages of a competing mode (372 U.S. at 758). And it added:

> If a carrier is prohibited from establishing a reduced rate that is not detrimental to its own revenue requirements merely because the rate will divert traffic from others, then the carrier is thwarted from asserting its own inherent advantages of cost and service. (372 U.S. at 759)

We note that in the situation before us the Commission found not only that the reduced rail rate would be compensatory, but that it would produce greater revenues in excess of out-of-pocket costs than would the former higher rate. The reduced rate therefore will not be detrimental to the railroads' revenue requirements. In these circumstances and in light of the inadequacy of the Commission's report with respect to the recognition and preservation of inherent advantages, we are of the belief that *New Haven* provides no support for the Commission's order.

We also hold that the Commission has failed to state a rational basis to support its selection of the "fully-

distributed" costs of the barge-truck mode as the floor for reduced railroad rates. The Commission said:

> In short, by reducing its rate below the level of the barge-truck full costs, the respondent railroads have unlawfully impinged upon the ability of the barge-truck mode competitively to assert its inherent cost advantage. This action we cannot approve. To hold otherwise we would deprive barges from asserting an inherent cost advantage and we would deprive shippers of cheaper water transportation. Cf. *Interstate Commerce Commission* v. *Mechling*, 330 U.S. 567, 575-579 (1947); *Dixie Carriers, Inc.* v. *United States*, 351 U.S. 56 (1956). (326 I.C.C. at 85)

How does the reduced railroad rate deprive shippers of cheaper water transportation? It appears to us to only provide shippers with an alternative form of transportation at an equivalent rate. The decisions cited by the Commission furnish no support for its conclusion, since none was concerned with Section 15a(3) or the setting of minimum rate floors. In *Mechling*, railroads carrying grain from Chicago to Eastern cities were charging more for carrying grain which arrived in Chicago by water carrier than for grain which arrived by rail. The Supreme Court upheld the Commission in finding that this action discriminating against water carriers violated § 3(4) of the Act. In *Dixie Carriers*, the railroads had refused to establish a joint rail-barge rate between two points in Texas. The Supreme Court held that this refusal constituted a discrimination in rates between connecting lines prohibited by § 3(4) of the Interstate Commerce Act, and that the Commission had a duty under § 307(d) to establish through routes and joint rates for rail-barge transportation. No such issue of discrimination is presented here.

We cannot escape the conclusion that the ultimate finding that the rates in issue are not just and reasonable

was motivated by the Commission's desire to prevent any rate competition which threatens the continued existence of a competitor. In support of its determination to employ a comparison of "fully-distributed" costs to determine which mode possesses an inherent advantage, the Commission stated its belief that "an inherent cost advantage under the National Transportation Policy reasonably could not embrace a concept that would impair the ability of a carrier not only to compete but to exist" (326 I.C.C. at 82). This rationale is directly in conflict with the conclusion of the Supreme Court in *New Haven*. (See our last above quote of the Court from that case.)

It is our belief that the Commission's order is based upon a misinterpretation or misapplication of the relevant statutory provisions. We gain support from the legislation itself, its history, and its application in other recent cases. In *Missouri Pacific R.R. Co.* v. *United States*, 203 F.Supp. 629, 633 (E.D. Mo. 1962), a three-judge District Court stated:

> "As far back as 1945, in the case of New Automobiles in Interstate Commerce, 259 I.C.C. 475, the Commission had said, l. c. 538:
>
> > 'As Congress enacted separately stated rate-making rules for each transport agency, it obviously intended that the rates of each such agency should be determined by us in each case according to the facts and circumstances attending the movement of the traffic by that agency. In other words, *there appears to be no warrant for believing that rail rates, for example, should be held up to a particular level to preserve a motor-rate structure, or vice versa.*' (Emphasis added)

In spite of these words, the Commission had, in a line of cases through the early 1950's, often canceled reduced rates, though they were fully compensatory.

> While the Commission has traditionally contended that such cancellations were not ordered to protect other modes, the Congress felt otherwise, and enacted Section 15a(3) at least in part as a direction to the Commission to treat competitive rate cases in a manner consistent with the language and spirit of New Automobiles."

We do not think there can be any doubt that the underlying purpose of Congress in enacting Section 15a (3) was to direct the Interstate Commerce Commission to observe the original intent of Congress in 1940 and to restore and adhere to the policy set forth in *New Automobiles* with respect to the preservation of inherent advantages. Both the Senate and House Committee Reports are explicit on this matter,[1] and there were also

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[1] The Senate Report, after stating it "agrees with and wishes to emphasize the import of" the Senate Subcommittee report, quotes the following from it:

> It nevertheless appears that the Interstate Commerce Commission has not been consistent in the past in allowing one or another of the several modes of transportation to assert their inherent advantages in the making of rates. The subcommittee recommends, therefore, that the Commission consistently follow the prinpicle of allowing each mode of transportation to assert its inherent advantages, whether they be of service or of cost. In 1945 in New Automobiles in Interstate Commerce (259 I.C.C. 475), the subcommittee believes that the Commission properly construed the intent of Congress in this respect when it said:
>
> > 'As Congress enacted separately stated rate-making rules for each transport agency, it obviously intended that the rates of each such agency should be determined by us in each case according to the facts and circumstances attending the movement of the traffic by that agency. In other words, there appears no warrant for believing, that rail rates, for example, should be held up to a particular level to preserve a motor-rate structure, or vice versa' (259 I.C.C. at p. 238).
>
> The subcommittee wishes to affirm the interpretation of the Commission given in the Automobile case epitomized in the words quoted above. The subcommittee therefore believes it

repeated statements of such an intent in the hearings and debates on Section 15a(3).[2] See *Interstate Commerce Comm'n* v. *New York, N.H. & H. R.R. Co.*, 372 U.S. 744, 755-56 (1963).

There are indications that Congress believed the National Transportation Policy would not prevent carriers from establishing rates which exceeded out-of-pocket costs in the kind of situation here presented. For example, Congressman Wolverton, who was a member of the House Commerce Committee, which reported the bill, said that: "If each mode of transportation is permitted to have rates not below a compensatory figure so that competition can really exist, I think you are then preserving the rights, the inherent rights of each."[3] Congressman O'Hara, another member of the House Commerce Committee, stated that: "If [one] mode of transportation has a compensatory rate and it is lower than that of the competitor, the Interstate Commerce Commission would have to allow [it] to charge a lower rate." (104 Cong. Rec. 12536)[4] A list of "Decisions of the Interstate Com-

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necessary to amend the act only so as, in effect, to admonish the Commission to be consistent in following the policy enunciated in the Automobile case thus assuring reasonable freedom in the making of competitive rates.

The subcommittee anticipates that the broad effect of this amendment will be to encourage competition between the different modes of transportation to the benefit of the shipping public. S. Rep. No. 1647, 85th Cong., 2d Sess., pp. 2-3.

The House Report is to the same effect. H. Rep. No. 1922, 85th Cong., 2d Sess., p. 14.

[2] See, *e.g.*, 104 Cong. Rec. 10842, 12531, 12532; Hearings on S. 3778 before the Senate Committee on Interstate and Foreign Commerce, 85th Cong., 2d Sess., pp. 14, 29, 178.

[3] Hearings on Railroad Problems Before a Subcommittee of the House Committee on Interstate and Foreign Commerce, 85th Cong., 2d Sess., p. 409.

[4] Senators Schoeppel, Lausche and Smathers likewise indicated that compensatory rates should normally be permitted. Hearings

merce Commission in Which the Policy of the New Automobiles Case Has Not Been Followed", which was before Congress in 1958, likewise makes it plain that Congress was concerned about cases in which the Commission had declared reduced rates unlawful, although finding that they were compensatory. See Hearings on S. 3778 Before the Senate Committee on Interstate and Foreign Commerce, 85th Cong., 2d Sess., pp. 86-91, 174-175.

In a more general vein, the Committees reporting on the bill emphasized that the chief thrust of the amendment was to encourage competitive ratemaking among the different modes of carriage. The Report of the Senate Committee on Interstate and Foreign Commerce described Section 15a(3) as "designed to encourage competition * * * by allowing each form of transportation * * * full opportunity to make rates reflecting the inherent advantages each has to offer * * *" and it expressed approval of the following language of the Supreme Court in *Schaffer Transportation Co.* v. *United States*, 355 U.S. 83 (1957):

> The ability of one mode of transportation to operate with a rate lower than competing types of transportation is precisely the sort of 'inherent advantage' that the congressional policy requires the Commission to recognize.

S. Rep. No. 1647, 85th Cong., 2d Sess., p. 3; and see H. Rep. Co. 1922, 85th Cong., 2d Sess., pp. 13-15.

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on S. 3778 Before the Senate Committee on Interstate and Foreign Commerce, 85th Cong., 2d Sess., pp. 11, 56 and 111. Moreover, we note that Congress specifically rejected a provision which would have prevented carriers from offering rates below fully-distributed costs in cases of inter-modal competition. Senator Lausche indicated that the proposal, if adopted, "would completely negative the purposes and intent of the Congress in 1940 and in 1953 when it declared that the inherent advantages of each mode of transportation shall be preserved in the interest of the public". Hearings on S. 3778, *supra*, p. 26.

We observe that the specific Congressional mandate in 1958 was that the Commission *should henceforth be bound in establishing minimum rates by the original intent of Congress in 1940* and the decision of the Commission in *New Automobiles*. In *New Automobiles* the Commission conducted a general investigation of all rates subject to its jurisdiction applying to the transportation of new automobiles, including rates of various forms of rail, truck and water carriage. The motor carriers, who initiated the proceeding, alleged that rail reductions made on an out-of-pocket basis would deprive them of their inherent advantages which the Commission was obligated to preserve by the terms of the National Transportation Policy (259 I.C.C. 539), and asked the Commission "to lay down the principle that in meeting highway competition the railroads should in no instance go below the fully-distributed rail costs or the truck rates" (259 I.C.C. 530). The railroads, on the other hand, asked that they be left free to meet competition by reducing rates to whatever level was necessary in order to attract traffic, provided their rates exceeded out-of-pocket costs (*Id.* at 532-33).

In determining "the relative fitness of the various agencies of transportation" from a cost standpoint, the Commission there compared the railroads' out-of-pocket costs with the truck "full" costs, after finding that the truck "full" costs were substantially the same as its out-of-pocket costs (259 I.C.C. at 529). Upon this comparison, which essentially was of the two modes' out-of-pocket costs, the Commission found that for shorter distances the motor carriers were the low-cost agency, while for the longer distances the cost advantage was with the railroads. Finding that, "According to the cost studies the rates of the several forms are generally compensatory, except in scattered instances", it held that the rates exceeded a "reasonable minimum level" and were lawful. It defined a compensatory rate as "one which is re-

munerative, i.e., covers the out-of-pocket costs, as hereinbefore defined, of handling the particular traffic under consideration, including a proper return on investment".

Noting that "within reasonable limits the public is entitled to the reduced rates brought by competition", the Commission indicated that its decision carried out the intent of Congress.

Thus, in *New Automobiles*, the Commission indicated its understanding that Congress intended that carriers should normally be free to offer rates which were compensatory. This construction of the National Transportation Policy is clearly supported by the legislative history of the Transportation Act of 1940. Congress not only rejected all proposals which would have prevented carriers from offering compensatory rates which were below fully-distributed costs, including the so-called Miller-Wadsworth amendment,[5] but in so doing it made

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[5] The so-called Miller-Wadsworth amendment to the minimum rate section would have provided:

> In order that the public at large may enjoy the benefit and economy afforded by each type of transportation, the Commission shall permit each type of carrier or carriers to reduce rates so long as such rates maintain a compensatory return to the carrier or carriers after taking into consideration overhead and all other elements entering into the cost to the carrier or carries for the services rendered. (84 Cong. Rec. 6074)

This amendment was included in the bills originally passed by the Senate and the House (84 Cong. Rec. 6074, 9962, 9977), but the Joint Conference Committee of the Senate and the House, to whom these bills were referred, eliminated it. Following lengthy debate, particularly in the House, as to whether it should be restored, ultimately both the Senate and the House voted not to restore it (86 Cong. Rec. 10193-94, 11766-67). Various other proposals which were advanced to prohibit rates below fully-distributed costs in inter-modal competitive situations were also rejected. See H.R. 2531, 76th Cong., 1st Sess., sec. 41; Hearings on S. 1310 and S. 2016, S. 1869 and S. 2009 Before the Senate Committee on Interstate Commerce, 76th Cong., 1st Sess., p. 698.

> . . . It is unnecessary that each individual rate, in order to be profitable, must bear its full share of all costs, including over-

known its belief that such a restriction on competition would be extremely undesirable both from the standpoint of shippers and from the standpoint of the general public seeking the most efficient use of transportation resources.

For example, in explaining why the Miller-Wadsworth amendment was rejected, Congressman Wolverton, one of the managers of the bill in the House and a House conferee as well as a member of the House Commerce Committee, stated:

> The amendment would not only slow up and seriously hamper all reductions but would absolutely prevent a great many desirable reductions from being made.

We believe that the Commission failed to take adequate account of the Congressional intent that carriers should normally be free to offer rates which are compensatory, i.e., above relevant out-of-pocket costs. Moreover, we think the Commission's decision here is inconsistent with its philosophy in *New Automobiles*. The Commission's order is therefore not in accordance with law.

We do not mean to suggest that there may not be situations where the Commission has power, under Section 15a(3) and the National Transportation Policy, to prohibit reduced rates even though they are compensatory. What we do suggest is that Congress has expressed a clear intent that reduced compensatory rates should normally

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head, and produce a reasonable profit above such costs. If a rate is high enough to pay more than out-of-pocket operating expenses, it helps meet some of the constant overhead.

. . . We should do nothing that will unnecessarily prevent or delay rate reductions; strike a blow at the fundamental principle of rate making upon which this country was developed, and obstruct or hinder the free flow of commerce which is so essential to our economic welfare. (86 Cong. Rec. 10190-91)

And see 84 Cong. Rec. 9963, 9970; 86 Cong. Rec. 10179, 10187, 11766-67.

be allowed and that the record here and the Commission's report supply no basic for disregarding that intent.

For the foregoing reasons, the order of the Commission in *Ingot Molds, Pa. to Steelton, Ky.*, 326 I.C.C. 77 (1965), is hereby set aside and permanently enjoined and the matter is remanded to the Commission for action not inconsistent with this opinion.

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF KENTUCKY
AT LOUISVILLE

Civil Action No. 5227

LOUISVILLE AND NASHVILLE RAILROAD COMPANY and
THE PENNSYLVANIA RAILROAD COMPANY,
Plaintiffs,

v.

UNITED STATES OF AMERICA and
INTERSTATE COMMERCE COMMISSION,
Defendants.

JUDGMENT

This cause having been heard on the plaintiffs' complaint seeking to enjoin, set aside and annul a report and order of the Interstate Commerce Commission, dated December 2, 1965, in a proceeding styled Investigation and Suspension Docket No. 8038, *Ingot Molds, Pa. to Steelton, Ky.*, 326 I.C.C. 77 (1965); and the parties appearing by counsel having been heard and the issues duly tried; and the Court having concluded in its opinion that plaintiffs are entitled to judgment:

It is hereby Ordered, Adjudged and Decreed that the above described report and order of the Interstate Commerce Commission, entered December 2, 1965, be set

aside and the Interstate Commerce Commission is hereby enjoined from enforcing it with prejudice. The matter is remanded to the Commission for reconsideration and such further action as the Commission may deem appropriate, not inconsistent with the opinion this day rendered by this court.

Issued at Louisville, Kentucky, this 15th day of May, 1967.

/s/ Harry Phillips
HARRY PHILLIPS
United States Circuit Judge

/s/ Henry L. Brooks
HENRY L. BROOKS
United States District Judge

/s/ James F. Gordon
JAMES F. GORDON
United States District Judge

A Copy: Attest

MARTIN R. GLENN, Clerk

By /s/ Loraine Milly
Deputy Clerk

Statutes Involved

SECTION 15a(3) OF THE INTERSTATE COMMERCE ACT (49 U.S.C. § 15a(3))

In a proceeding involving competition between carriers of different modes of transportation subject to this Act, the Commission, in determining whether a rate is lower than a reasonable minimum rate, shall consider the facts and circumstances attending the movement of the traffic by the carrier or carriers to which the rate is applicable. Rates of a carrier shall not be held up to a particular level to protect the traffic of any other mode of transportation, giving due consideration to the objectives of the national transportation policy declared in this Act.

NATIONAL TRANSPORTATION POLICY (49 U.S.C., preceding §§ 1, 301, 901, and 1001)

It is hereby declared to be the national transportation policy of the Congress to provide for fair and impartial regulation of all modes of transportation subject to the provisions of this Act so administered as to recognize and preserve the inherent advantages of each; to promote safe, adequate, economical, and efficient service and foster sound economic conditions in transportation and among the several carriers; to encourage the establishment and maintenance of reasonable charges for transportation services, without unjust discrimination, undue preferences or advantages, or unfair or destructive competitive practices; to cooperate with the several States and the duly authorized officials thereof; and to encourage fair wages and equitable working conditions; all to the end of developing, coordinating, and preserving a national transportation system by water, highway, and rail, as well as other means, adequate to meet the needs of the commerce of the United States, of the Postal Service, and of the national defense. All of the provisions of this Act shall be administered and enforced with a view to carrying out the above declaration of policy.

Investigation and Suspension Docket No. 8038

INGOT MOLDS, PA., TO STEELTON, KY.

Decided February 2, 1965

Proposed multiple-car rate, minimum 600 gross tons, on ingot molds and ingot mold stools from Neville Island and Pittsburgh, Pa., to Steelton, Ky., found just, reasonable, and otherwise lawful. Proceeding discontinued.

Carl Helmetag, Jr., and *E. R. Leigh* for respondents.

Harry C. Ames and *Wesley A. Rogers* for protestants.

REPORT AND ORDER OF THE COMMISSION

DIVISION 2, COMMISSIONERS FREAS, TUCKER AND TIERNEY

FREAS, *Commissioner:*

By schedules filed to become effective on December 1, 1963, the respondent railroads [1] proposed to establish a reduced rate [2] on ingot molds and ingot mold stools,[3] both herein called ingot molds, from Neville Island and Pitts-

[1] The Pennsylvania Railroad Company and the Louisville and Nashville Railroad Company, hereinafter called the Pennsylvania and the L. & N., respectively.

[2] Rates, differences in rates, costs, and charges are stated per gross ton of 2,240 pounds, unless otherwise indicated.

[3] An ingot mold is a cast-iron form in which molton steel is cast in making ingots. The stool is the base upon which open-bottom molds stand.

burgh, Pa., to Steelton, Ky., of $5.11 when moved in single shipments of not less than 600 gross tons, minimum 112,000 pounds per car (12 or fewer cars), on one bill of lading, from one consignor at one origin to one consignee at one destination, with delivery to the originating railroad to be completed on one day. Upon protest of the Waterways Freight Bureau, the operation of the schedules was suspended to and including June 30, 1964, and an investigation was instituted. The effective date of the schedules has been voluntarily postponed to and including March 31, 1965. Evidence was submitted at the hearing by the respondents in support of the proposed rate, and in opposition thereto by the aforementioned bureau and certain of its members,[4] collectively called protestants. Due and timely execution of our functions under section 15(7) of the Interstate Commerce Act imperatively requires the omission of recommended report and order in this proceeding.

The ingot molds involved herein move principally by barge in connection with truck delivery from the producing plant of the Shenango Penn Mold Company at Neville Island, located in the Pittsburgh port area, to the Green River Steel Corporation at Steelton, 3.5 miles from the Owensboro, Ky., river-rail terminal where barge facilities are located. The shipper's plant is served by the Pennsylvania in connection with the short-line railroad, the Pittsburgh, Chartiers & Youghiogheny Railway Company, hereinafter referred to as the P. C. & Y., and the receiver's plant is served directly by the L. & N.

The proposed rate of $5.11 is equal to the overall charges to the receiver for the barge movement. The latter consist of a barge rate of $3.32, minimum 600 gross tons, a barge-to-truck transfer charge of 95 cents

[4] Mississippi Valley Barge Line Company, Ohio River Company, and Union Barge Line Company.

at Owensboro, and the for-hire truck charge of 84 cents for the movement from Owensboro to Steelton. The present rail rate is $11.86,[5] subject to a carload minimum of 100,000 pounds.

From 1953, following the completion of the receiver's plant at Steelton, to the present time, the movement has been almost exclusively by barge. From 1953 to 1963, the barge rates have increased from $2.84 to $3.32, and the minimum has increased from 500 to 600 gross tons. Notwithstanding the increased minimum weight and rate, net tonnages of 3,878, 4,320, and 5,017 in 1961, 1962, and 1963, respectively, indicate a steady rise in the volume of this traffic moving by barge in recent years. During the first 3 months of 1964, the barge tonnage was 1,500. Barge shipments, on the average, exceed 600 tons. Analysis of systemwide revenues for bureau members for 1962 indicates that iron and steel, which includes class 579 in which the carriers report ingot molds for statistical purposes, is the third most important commodity group transported in barge service, accounting for 10.81 percent of total revenue. It is 1 of 11 commodity groups which account for 81.45 percent of total barge traffic.

In 1953, the rail rate was $13.50, minimum 50,000 pounds. In 1958, it reached a high of $16.72, same minimum, before it was reduced to $12.52, minimum 100,000 pounds. Subsequently, it was reduced to the present rate of $11.86.

The stated purpose of the instant proposal is to enable the respondents to compete for this traffic. Rail shipments have been limited to isolated instances when the receiver's production schedules have required special orders of certain kinds of ingot molds. For example, in 1962 the railroads moved two shipments aggregating 112

[5] This is a conversion of the rate per net ton of $10.59, shown in the tariff, to a gross-ton basis.

net tons; in 1963, five shipments aggregating 276 net tons; and during the first 3 months of 1964, two shipments aggregating 116 net tons. Consignee testimony indicates that if the railroads are to participate substantially in the movement it will be necessary to have a rail rate not exceeding the total cost to the consignee of the present method of handling the ingot molds via barge-motor service.

COST CONSIDERATIONS

Cost studies were submitted by the respondents and the protestants. They are discussed in detail in the appendix hereto. As stated therein, the respondents computed out-of-pocket costs as 483.5 cents, utilizing eastern district and southern region costs based on railroad cost scales by territories for the year 1961, contained in public statement No. 5-63 prepared by our cost finding section, and as 468.9 cents, by the application of Rail Form A to operating data of each respondent for the year 1962. Excluding return on investment, the respective costs are shown as 432 and 419 cents. Fully distributed costs are shown as 759.4 cents.

The protestants restated the respondents' statement No. 5-63 costs as 505.8 cents on an out-of-pocket basis, and 785 cents on a fully distributed basis. They also compute the average rail full cost by various methods as 759.4, 617.1, 687.9, and 564.3 cents. These methods are described in the appendix hereto, and the differences in the out-of-pocket and fully distributed costs as computed by the respondents and the protestants are also discussed therein.

Recognizing that costs are not always ascertainable with mathematical precision, we have found in the appendix hereto that the rail out-of-pocket costs reasonably approximate 468.9 cents, as shown by the respondents upon individual application. Eliminating return on in-

vestment,[6] they would be substantially lower. The rail fully distributed cost figure of approximately 759 cents is reached in a manner consistent with recognized procedures if the use of territorial averages is accepted. Having found the costs upon individual application to be more appropriate however, those on a fully distributed basis would be somewhat lower than 759 cents. We therefore find that the proposed rate exceeds the respondents' out-of-pocket costs, but is below their fully distributed costs:

The protestants, based on the Commission cost section's new Barge C formula, compute the cost of transporting this traffic by the Mississippi Valley Barge Line Company. The record fails to demonstrate, however, that those costs are reasonably representative of the costs of all protestants of record. In any event, when the aggregate charges of $1.79 for barge-to-truck transfer and for-hire trucking are included,[7] the full costs are computed as 535.68 cents, based on an operating ratio for that bargeline of 87.9 percent (the company's average for the last 3 years), and as $5.1959, including a return on investment of 4 percent. To compare validly with rail fully distributed costs, use of the latter figure is more appropriate.

Four transportation economists testified in respondents' behalf to the effect that incremental or out-of-pocket cost, rather than fully distributed cost, is the proper basis both for establishing pricing floors and also for determining the most economic form of transportation. They urge that no meaningful comparison of full costs can be made in this proceeding because of the dissimilarity between the rail and water cost formulas in allocating overhead

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[6] *Cf. Coal from Southern Mines to Tampa and Sutton, Fla.*, 318 I.C.C. 371; *Baltimore & O. R. Co.* v. *Chicago & E. I. R. Co.*, 322 I.C.C. 572.

[7] See *Sugar, South to Indiana, Ohio River, Intermediate Points*, 319 I.C.C. 782, 784, 785.

costs to the traffic involved. They further contend that only in competitive situations between regulated modes has the use of fully distributed costs ordinarily been found controlling, and that there is no sound justification for such usage.

Service Considerations

Protestants contend that the bargelines are disadvantaged at a parity of charges because of inferior service, and cite the loss of other traffic when differentials were eliminated. However, a comparison of the services indicates that loss and damage has not been experienced on the barge movement and the consignee anticipates none on the rail movement. The rail line-haul service is faster. Nevertheless, considering that plant facilities are adequate to receive shipments of 600 gross tons and the movement is primarily to stockpile, the advantages of faster rail service are not material to consignee. The consignor bears the cost, and must arrange, for the movement of the traffic from its mill to the barge dock and for loading the traffic into the barge. The rail service is door to door, but the intraplant switching of rail cars is performed by the consignee in its equipment and at its expense. It is protestants' position that they can only participate in this traffic when the cost to the shipper is less than all-rail service.

General Discussion and Ultimate Conclusions

For carriers to remain in business constant costs must be recovered, which is to say that full costs in the aggregate must be obtained if the Nation's transportation system is to be healthy. Thus, whenever competive carriers of different modes assert cost advantages inherent to their respective modes, we have recognized in fully distributed costs the only sound standard of measurement reflecting as many attributable constant costs as it is

reasonably practicable to apportion. Difficulties of apportioning constant costs do prevail. See *Grain in Multiple-Car Shipments—River Crossings to So.*, 321 I.C.C. 582, 597, reversed on other grounds in *Cincinnati, N. O. & T. P. R. Co.* v. *United States*, 220 F. Supp. 46 (S. D. Ohio 1963), appeal docketed, U. S. July 29, 1964, (No. 545). Since constant costs are not directly related to service units, they are assigned on an average statistical basis. In our opinion, however, that assignment does not detract from their worth.[8] We adhere to the utilization of fully distributed costs as the standard for determining the inherent advantage of low cost in the situation presented. Stated differently, we recognize the existence of constant costs. The use of out-of-pocket or incremental costs advanced herein by respondents ignores them. We decline to so limit our ratemaking powers.

However, a determination that the advantage of low cost lies with one mode or another does not end matters. Nor is such a determination necessarily to be equated with the appropriate rate level. We are not bound by a mechanical formula. Rather, it must be found that a competing rate is destructive of such an advantage. A finding to this effect must of necessity rest with the facts and circumstances in each case.[9] Here, it cannot be controverted that protestant bargelines have chosen for some time to forego the revenues of a rate set at a level which would return fully distributed costs. They have done so voluntarily and, considering the rail rate levels and the fact that the traffic has moved almost exclusively by barge since 1953, without being subject to any compe-

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[8] Compare our action in divisions cases under section 15(6) in *Louisville & N. R. Co.* v. *Southern Ry. Co.*, 319 I.C.C. 639, 660, sustained in *Carolina & N.W. Ry. Co.* v. *United States*, 230 F. Supp. 581 (W. D. N. C. 1964), appeal docketed, U. S. Nov. 16, 1964.

[9] *Cf. Reduced Transcontinental Lumber Rates, 1961*, 318 I.C.C. 815, 844.

titive compulsion insofar as respondents are concerned.[10] From all that appears of record, protestants' choice in setting their rate at the level respondents now seek merely to meet was also reached voluntarily. Such action affords no basis for assuming that the action of respondents in meeting but not undercutting protestants' rate destroys an inherent cost advantage. Indeed, we think it plain that protestants, being in a position of their own free choosing, cannot successfully object to a rate which, we find, will return revenues reasonably in excess of out-of-pocket costs and which is designed merely to meet competition with its resulting benefit to the shipping public. It is well to note as to shippers that there is a public interest aspect in reductions to be achieved through competitive rate making which we are required to recognize in addition to the revenue considerations of the respective modes. Moreover, the proposed rate reasonably appears to be designed to contribute in the aggregate to the constant costs and will afford respondents the opportunity to utilize equipment more fully thereby reducing unit costs. This is so despite protestants' assertion that respondents received greater revenue in excess of out-of-pocket costs under the present $11.86 rate in 1963 in handling five carloads of the involved traffic than they would if they had secured, under the proposed rate, the entire 1963 tonnage which moved by barge and rail. A contrary and more accurate result obtains when the costs we have found appropriate herein (468.9 cents) are utilized. Moreover, the steady rise in traffic movements in 1961, 1962, and 1963 permits an inference that greater tonnage will be available for future movements. Finally,

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[10] The last-mentioned factor in particular, as well as those discussed hereinafter, clearly distinguishes the instant proceeding from the situations presented in *Grain from Idaho, Oreg. & Wash. to Ports in Oreg. & Wash.*, 319 I.C.C. 534 (since reopened for further hearing), and *Pig Iron, Buffalo, N. Y., to Chicago, Ill., and Gary, Ind.*, 321 I.C.C. 121.

we see no basis for limiting respondents to what are in actuality isolated movements on special orders which may or may not occur again, or to subject the receiver to the much higher charges in such instances. In view of the foregoing, we find the proposed rate compensatory, and just and reasonable. It may readily be inferred that protestants would have raised their rate to a higher level heretofore had they themselves deemed it appropriate to protect their inherent advantage. However, their realization of what we must assume in the circumstances to be a profitable level of revenue at lower rates negates any sound basis for finding destructive competition or a tendency thereto. Indeed, the record impels the conclusion that protestants' cost advantage is such that they are in a position to continue to compete effectively and still charge a rate reasonably in excess of out-of-pocket costs, *cf. Interstate Commerce Commission* v. *New York, N. H. & H. R. Co.*, 372 U.S. 744, 761, n. 14 (1963), hereinafter called the *New Haven* case, even if they were to reduce their rate. Stated in another manner, the situation presented is one permitting the reasonable play of competition. *Cf.* Testimony of then Chairman Freas in Hearings Before the Subcommittee on Surface Transportation of the Senate Committee on Interstate and Foreign Commerce on Problems of the Railroads, 85th Cong., 2d sess., pt. 3, at 1884 *passim* (1958).

Service considerations as to the involved movement are not shown of record to be controlling. For example, stockpiling and adequate storage space do not necessitate faster service as such. In addition, certain aspects of the two services may be said to be largely offsetting. In this regard, the consignor must arrange for the movement to, and loading on, the barge when such service is utilized. Initially, it is not urged nor is it shown that this service factor and the absorption of the attendant costs by the consignor influence the routing of the traffic. *Cf. Penn-*

sylvania R. Co. v. *United States*, 202 F. Supp. 584 (E. D. Pa. 1962). As an offsetting factor, the consignee is required to perform intraplant switching in its own equipment at its expense. In any event, even assuming inferiorities in protestants' service, there would be corresponding advantages in that of respondents. The national transportation policy is directed to a recognition and preservation of inherent advantages.

In the circumstances presented, we find for the encouragement of lawful competition and conclude that the proposed rate is just and reasonable, and, consistent with the Court's evaluation of section 15a(3) in the *New Haven case*, not destructively competitive.

COMMISSIONER TUCKER concurs in the result.

It is ordered, That this proceeding be, and it is hereby, discontinued.

By the Commission, division 2.

BERTHA F. ARMES,
Acting Secretary

(SEAL)

APPENDIX

RESPONDENTS' COST STUDIES

The respondents submitted four cost studies. Two studies were based upon eastern district and southern region out-of-pocket costs, as shown in I.C.C. Statement No. 5-63. The other two are hereinafter referred to. The respondents also computed fully distributed costs using the eastern district for the Pennsylvania portion of the haul and the southern region for the L. & N. portion of

the haul. These fully distributed costs amounted to 759.4 cents per gross ton.

Territorial studies.—In their cost studies based on Statement 5-63, respondents applied territorial unit costs based on 50 gross tons per car, 600 gross tons per shipment, or a 12-car block with territorial average empty returns in order to reflect what they suggest to be the greatest cost anticipated from this movement.

For the purposes of the above cost studies, the P. C. & Y. and the Pennsylvania costs are based on eastern district out-of-pocket unit costs; and the L. & N. costs are based on southern region out-of-pocket unit costs. The cost study for the southern region was on the same basis as that for the eastern district.

The following are the out-of-pocket costs developed in these studies by respondents in transporting the traffic by rail;

	Total out-of-pocket costs	
	Including return on investment	Excluding return on investment
	(In cents per gross ton)	
P.C. & Y.-Pennsylvania costs based on eastern district Rail Form A (1961)	338.3	304.0
L. & N. costs based on southern region Rail Form A (1961)	145.2	128.0
Total	483.5	432.0

The respondents used the short routes of movement from Neville Island, Pa., to Duffs Junction or Scully, Pa., over the P. C. & Y. plus the movement beyond, over the Pennsylvania, to the latter's interchange point with the L. & N. at Cincinnati, Ohio. This movement involved 311 miles, 7 miles over P. C. & Y., and the remainder over the Pennsylvania.

The multiple-car shipment would be picked up at the interchange point by through train PMC-3 moving from Pitcairn Yard on the Pennsylvania to Columbus, Ohio. At Columbus it would be switched into train CIN-1 for movement to Cincinnati. From this point to Steelton, Ky., movement would be over the L. & N. for a distance of 220 miles. The entire movement would total 531 miles.

The respondents stated that since the P. C. & Y. was a class II railroad, there was not available any cost data relative to its operation. For the 7-mile movement by that carrier from Neville Island to Duffs Junction respondents used the origin terminal, way train, and interchange cost for the eastern district. Also, because this was a proposed movement it was not possible to develop any savings on the P. C. & Y. relative to billing costs and switching time; therefore, eastern district averages were used.

The movement from the interchange point at Scully to Cincinnati was costed on the basis of using the eastern district costs for the movement over the Pennsylvania.

As to switching operations, the respondents did not make any time study to the origination of a car but instead used the average eastern district switching minutes. They allowed 15.29 minutes each to place the empty car and remove the loaded car. These 15.29 minutes were, in turn, multiplied by 12 cars which totaled to 183.5 minutes. To place empties and remove loaded cars, the respondents, therefore, allowed 367 minutes. This operation was estimated to be 6 hours.

At the interchange point there were 7.65 minutes average per car for 12 cars. The interchange costs were increased for empty return movement; and the empty return ratio on gondola cars for the eastern district was used (74 percent). The respondents added 67.9 minutes

to handle the empties, and the total at the interchange point was given as 159.7 minutes.

For intertrain and intratrain switching, which respondents used at Columbus, the average per car was 4.59 minutes; this, in turn, was multiplied by 12 which resulted in 55.1 minutes. The above minutes were increased by the empty return ratio of 74 percent resulting in 95.9 minutes for switching at Columbus. This operation involved the handling from train PMC-3 to train CIN-1. Since the considered traffic was not moving in multiple cars, the respondents relied upon averages and these averages, they claim, overstated the movement.

Individual applications.—The respondents' other two cost studies were based on individual applications of Rail Form A for the Pennsylvania and the L. & N. for the year 1962. The individual application of Rail Form A formula for the Pennsylvania was developed for two purposes, one to show that the costs developed under Rail Form A are comparable to the eastern district costs with respect to the Pennsylvania costs; and secondly, as the respondents did not have available eastern district costs for the year 1962, the individual Rail Form A study was presented in substitution. Thus, the movement from the interchange point at Scully to Cincinnati was costed by applying cost factors developed under Rail Form A prepared for the Pennsylvania. Eastern district average origin terminal, way train, and interchange cost was applied for the move over the P. C. & Y.

The L. & N. also applied the individual application of Rail Form A formula for the year 1962. The purpose of its application is the same as that mentioned above for the Pennsylvania. The former also made adjustments of the interchange switching at Cincinnati (Decoursey Yard) with the Pennsylvania.

There was some doubt expressed by protestants regarding the switching at Decoursey Yard as to whether trains No. 75 and No. 158, used for this transportation beyond Cincinnati, were way trains or through trains, because some switching might be involved. This respondent stated that these trains are different from a way train or so-called local train in that they do no switching en route, while a local freight does. However, a through train may at certain points have a setoff of cars for business purposes but there is no switching involved. The L. & N. maintains that it should not take more than 25 minutes to set off cars at the Steelton plant.

The interchange switching at Cincinnati with the Pennsylvania was adjusted to reflect the cost resulting from this move. The cost per carload as shown by the L. & N. is $4.63. Also, intermediate switching at Louisville, Ky., has been adjusted to 40 percent of the average intermediate switching cost. This results in an intermediate switching cost of $2.69 per carload.

With respect to costs developed under the individual applications of Rail Form A formula for the Pennsylvania and the L. & N., the following is shown:

	Total out-of-pocket costs	
	Including return on investment	Excluding return on investment
	(In cents per gross ton)	
P.C. & Y. cost based on eastern district Rail Form A (1961); and Pennsylvania cost based on Pennsylvania Rail Form A (1962)	331.4	300.0
L. & N. cost based on L. & N. Rail Form A (1962)	137.5	119.0
Total	468.9	419.0

PROTESTANTS' RAIL COST STUDY

The protestants developed out-of-pocket and fully distributed costs applicable to movement of ingot molds in gondola cars, 112,000 pounds per car, 600 gross tons per shipment, from Neville Island to Steelton. These costs were based on territorial average costs utilizing Rail Carload Cost Scales by Territories for the Year 1961, Statement No. 5-63, prepared by the cost finding section.

The terminal costs were computed from table 3 of the above-mentioned statement and are the average of eastern district and southern region terminal costs for a gondola with a load of 50 tons and, in effect, assigned an eastern district origin cost, at Neville Island, and a southern region termination cost at Steelton.

The protestants used the docket No. 28300 mileage from Neville Island to Cincinnati increased 13 percent for circuity to encompass all the routes to Cincinnati. Eastern district unit costs were applied to the mileage. Further, the rate applies over the L. & N. beyond Cincinnati, and, therefore, the protestants apply southern region unit line-haul costs to the L. & N. mileage from that point to Steelton as shown in supplement 23, I.C.C. A-16622. The costs reflected the movements in way trains and through trains.

The total territorial interchange out-of-pocket costs per loaded car-mile and the constant cost per hundredweight mile were included in the respective line-haul costs. All unit costs per carload were divided by 50 gross tons, the number of gross tons in 112,000 pounds, the minimum weight per car for the $5.11 rate in the tariff. All unit costs shown in per hudred weight were multiplied by 22.4 to obtain unit cost per gross ton of 2,240 pounds.

A cost per gross ton of 5.6448 cents was included for loss and damage claim payments based on that shown for class 579 in appendix A, I.C.C. Statement No. 5-63.

The results of protestants' cost study for the traffic at issue indicate an out-of-pocket cost of 505.8 cents per gross ton and a fully distributed cost of 785.0 cents per gross ton.

Protestants also used respondents' 1961 eastern district and southern region costs to show average total cost (total operating expenses, return and recovery of passenger and less-than-carload deficits) allocated by Rail Form A, schedule G expense groups. The average total costs for the movement of ingot molds from Neville Island to Steelton using the method and operating factors employed by the rail respondents showed—

Movement (1)	Average total cost per gross ton (2)
	Cents
Within eastern district	475.0
Within southern region	212.9
Total	687.9

WATER COSTS

The Mississippi Valley Barge Line, hereinafter called the bargeline, introduced a cost study vased on Barge Form C. It was necessary, as stated by this protestant, to depart from Barge Form C in order to make several adjustments in the terminal areas at Pittsburgh, and in the unloading point at Owensboro, Ky., so as not to overstate costs on the actual movements involved in handling the traffic. The above is particularly true in respect to port service cost, i.e., tug and fleeting costs at origin and destination, which showed an average cost of $9.44 per loaded barge which represented the cost generally of maintaining and operating a fleeting area at Pittsburgh.

DISCUSSION OF THE COST EVIDENCE

We consider first the costs for rail movement.

In their statement No. 5-63 costs, respondents separated from the territorial line-haul costs the interchange switching and intertrain and intratrain switching and included these switchings as they occurred at Duffs Junction and Cincinnati. This procedure is acceptable, as Rail Form A provides for handling switching costs based on either: (1) actual known experience, or (2) on a mileage basis, when actual experience is not known.

Respondents' station clerical costs were not reduced to one-twelfth to reflect the fact that the shipment would be handled in 12-car multiple shipments.

Respondents' use of eastern district average through train weights is based on a 4- or 5-day study sufficiently representative of the proposed operations to be considered reasonably reliable. Similarly, for that portion of the traffic originating on and moving over the P. C. & Y., the respondents' use of the eastern district costs for origin terminal, way train, and interchange produces acceptable costs for that carrier.

Respondents' routing to Steelton of 531 miles was determined by using the actual distance over the P. C. & Y. to Duffs Junction of 7 miles, thence the Pennsylvania to Cincinnati of 304 miles, and then the L. & N. to destination of 220 miles. This routing, involving one actual interchange with no circuity added to the actual miles, is reasonable.

Protestants' rail cost study included 5.6448 cents per gross ton for loss and damage claim payments. This was the average for 1961 of some 20 different items, including iron, steel, and other metallic articles. The respondents in their cost computations did not include any item of

cost for this since the nature of the commodity involved makes unlikely the occurrence of loss and damage. Nor has the consignee experienced any loss or damage. In the circumstances, we agree with this omission.

The protestants made an adjustment in their costs for movements in 600-ton lots, a tariff requirement for the $5.11 rate, by dividing the station clerical expense by 12, the number of 50-gross-ton loaded cars in a 600-gross-ton movement.

Comparison of the respondents' and protestants' rail costs based on statement No. 5-63. (These costs include return on investment and allowance for Federal income taxes.)

	Rate	Out-of-pocket cost	Constant cost	Fully distributed cost
Respondents' exhibits Nos. 9 and 12 (excluding loss and damage)	511	483.5	275.9	759.4
Protestants' exhibit No. 5 (including loss and damage)	511	505.8	279.2	785.0

The respondents' out-of-pocket rail cost study in the eastern district is 14.8 cents more than protestants' out-of-pocket rail cost for the same district. The protestants' out-of-pocket rail cost study in the southern region is 31.4 cents more than the respondents' out-of-pocket rail cost for the same region. Thus, protestants' out-of-pocket rail cost study is 16.6 cents more than respondents'. This latter cost difference does not consider loss and damage costs. Respondents, as stated above, did not include a loss and damage cost in their study, whereas protestants included a cost of 5.6 cents per gross ton. Thus, adding the 5.6 cents to the 16.6 cents provides 22 cents, which

is the total difference between respondents' and protestants' out-of-pocket cost studies.

Protestants in their restatement of respondents' Statement 5-63 costs claim that respondents reduced their out-of-pocket switching costs in the southern region by 32.5 cents per gross ton based solely upon an operation described by an operating witness for respondents. According to protestants, the rail out-of-pocket cost restated to correct for this allegedly unwarranted adjustment in switching costs would be 516 cents per gross ton or 5 cents more than the proposed rate. The 516 cents is obtained by adding the 32.5 cents to respondents' cost of 483.5 cents per gross ton. Indeed, protestants' costs did not reflect any estimate of the reduction in costs (other than station clerical) for handling multiple-car shipments in heavier than average weight trains. However, cost reductions in such instances may be said to be axiomatic. *Asphalt to Iowa, Michigan, Minnesota, and Wisconsin*, 316 I.C.C. 117, 124. See also *Volume rates on Processed Meal—Midwest to Ports*, 322 I.C.C. 456, 485. Rail Form A computations recognize only to a limited degree reductions resulting from multiple-car shipments because applicable Rail Form A costs are based on average switching cost per car resulting from switching cuts of cars of various sizes.

Recent and pertinent cost experience of the past often furnishes an appropriate guide in judging rates for the future. However, if a carrier's costs per 100 pounds or other unit have been high because of low volume of traffic, the use of such costs to determine the reasonableness of a proposed rate, the very purpose of which is to increase a carrier's business, should of necessity be given careful consideration. For example, had the tonnage which a new rate is expected to produce been included in cost calculations the resulting costs would be much lower. Stated in another manner, in judging rates for the future reason-

able prognostications should be given weight. Here, respondents' expert operating witness testified that, in his opinion and on the basis of past experience, a reduction of switching costs would result from the proposed multiple-car movements. As indicated, cost reductions in such situations are axiomatic. Moreover, protestants' cost witness appeared to recognize the foregoing for, when asked if anything, in his opinion, would preclude an actual reduction of the costs resulting from multiple-car movements, he stated:

> No, sir. A study that would be made which would show the time elements for the various types of switching could be made, and it would adjust from the particular point at which the formula had actually developed cost.

In light of the foregoing and since the respondents' witness has not been successfully rebutted, we conclude that the reduction in switching costs would occur. We are convinced that it is more reasonable to recognize the reduction than to reject it.

As to the respondents' individual Rail Form A applications, apart from the aforementioned criticisms as to the territorial costs, protestants appear to find fault here only to the extent that the Pennsylvania did not show the system factors used in preparing its individual carrier costs. However, it appears of record that the respondents' working papers were submitted to the protestants and stood unchallenged at the hearing. In our opinion, the individual cost applications reflect reasonable adjustments appropriate in the circumstances for proposed movements, and stand unrebutted. We so find. While costs cannot be pinpointed here exactly, we conclude that the out-of-pocket costs for the proposed movement reasonably approximate those adduced by respondents by individual application; individual, more specific showings being preferable to territorial averages.

Intermodal cost comparisons

Cost level (1)	Respondents (2)	Protestants (3)	Protestants (4)
	(In cents per gross ton)		
1. Rail out-of-pocket costs:			
1. Territorial costs, statement No. 5-63, adjusted	[1]483.5	[2]505.8	[3]516.0
2. Individual Rail Form A Pennsylvania and L. & N.	[1]468.9		
2. Rail fully distributed costs:			
1. Territorial costs, statement No. 5-63, adjusted	759.4	[2]785.05	(a)759.4
3. Rail average total cost: (or "Full Cost")			(b)617.1
			(c)687.9
			(d)564.3
4. Barge costs: Average total		[4]519.6	
		[5]535.6	

[1] Includes movement of P.C. & Y at eastern district costs for 1961.

[2] This figure was computed and submitted by protestants (Waterways Freight Bureau).

[3] Respondents' territorial out-of-pocket costs (483.5 cents per gross ton) corrected by protestants to adjust for respondents' understatement of switching costs in the southern region; i.e., 32.5 cents (483.5 + 32.5 = 516).

[4] Includes the ancillary charge for transfer and trucking services at destination of 179.0 cents per gross ton plus an operating cost of 340.6 cents per gross ton which included a 4-percent return on investment after Federal income taxes. The latter figure (340.6 cents) is derived by applying return on investment ratios to the respective towboat, barge, and port service costs to arrive at a total cost of $2,119.93 per bargeload. This figure, in turn, is divided by the "load-per-barge factor" of 701.75 net tons (2,000 pounds) resulting in a cost of 3.0209 cents per net ton, to which is added the cargo loss and damage cost of 2.01 cents per ton and provides a cost of 3.0410 cents per net ton. The latter figure is then multiplied by the ratio of 1.12 to expand from cents per net ton to cents per

The above figures for items (a), (b), (c), and (d) represent the result of the protestants' four basic methods for determining "rail full cost." All calculations are based on respondents' territorial costs, statement No. 5-63 adjusted, from which respondents developed an out-of-pocket cost of 483.5 cents per gross ton. The following identifies the four methods:

(a) *Distribution of rail constant costs on basis of service units.*—This method uses the Rail Form A ton and ton-mile distribution of constant costs, which protestant determines to be 275.9 cents and added to respondents' out-of-pocket cost of 483.5 cents to provide the cost of 759.4 cents per gross ton.

(b) *Distribution of rail constant cost on basis of revenue need.*—This method increases the out-of-pocket costs (483.5 cents) by a "carload revenue need ration," determined separately for the eastern district and southern region by dividing the total sum of (1) gross freight revenue—carload, and (2) freight switching revenue (total out-of-pocket expense—carload minus Switching and Terminal Co. out-of-pocket expense and return). The resulting ratios are: eastern district, 1.209; southern region, 1.433. The calculations are:

	Out-of-pocket	Revenue need ratio	Total
	Cents		*Cents*
Eastern district	338.3	1.209	409.0
Southern region	145.2	1.433	208.1
Total	483.5	.....	617.1

gross ton, which produces an operating cost of 340.6 cents per gross ton.

[5] Includes barge costs of 279.93 cents per net ton (or 313.52 cents per gross ton) divided by an operating ratio of 87.9 which provides the figure of 356.68 plus 179 cents per gross ton for ancillary charge resulting in 535.68.

(c) *Average total cost including return on investment and operating deficits.*—Average total cost here consists of total operating expenses, rents, and taxes; 4 percent return on investment (100 percent of road and equipment), after Federal income taxes; and passenger and less-than-carload deficits (exhibit No. 35).

(d) *Average total cost including average revenue need.*—This method consists of rail total operating expenses, rents, and taxes (excluding Federal income taxes) increased by an "average revenue need," the latter revenue need being computed as the ratio of freight operating revenue to freight operating expenses, rents, and taxes (excluding Federal income taxes).

Served December 2, 1965

30300

INTERSTATE COMMERCE COMMISSION

Investigation and Suspension Docket No. 8038

INGOT MOLDS, PA., TO STEELTON, KY.

Decided November 9, 1965

On reconsideration, reduced multiple-car railroad rate on ingot molds, mold stools, and sprue plates from Neville Island and Pittsburgh, Pa., to Steelton, Ky., found unjust and unreasonable, and in contravention of the national transportation policy. Findings in prior report, 323 I.C.C. 758, reversed, schedules ordered canceled, and proceeding discontinued.

Appearances as shown in the prior report and, in addition, *Thomas M. Knebel* and *Bryce Rea, Jr.*, for intervener.

REPORT AND ORDER OF THE COMMISSION ON RECONSIDERATION

BROWN, *Commissioner:*

In the prior report, 323 I.C.C. 758, decided February 2, 1965, division 2 found just, reasonable, and otherwise

lawful the reduced railroad rate [1] of $5.11 on ingot molds, mold stools, and sprue plates, hereinafter called ingot molds, from Neville Island and Pittsburgh, Pa., to Steelton, Ky. Upon petition of the respondent railroads [2] and the protestant bargelines,[3] the proceeding was reopened by the Commission for reconsideration on the present record. The National Motor Freight Traffic Association, Inc., was permitted to intervene and file a reply to the respondents' petition.

These schedules became effective March 19, 1965. For convenience, however, the rate at issue will be called the proposed rate. The facts are adequately set forth in the prior report, and will be restated only where helpful for a clear understanding of the issues.

Since 1953, the movement of this traffic has been principally by barge-truck. The overall charge of $5.11 for movement by barge-truck consists of a barge rate of $3.32, minimum 600 gross tons, a barge-to-truck transfer charge of 95 cents at Owensboro, Ky., and a for-hire truck charge of 84 cents beyond. In 1953, the barge rate was $2.84, minimum 500 gross tons. That rate was subsequently increased to the present level and minimum, which were attained in November 1960.

Prior to the publication of the proposed rate, rail shipments were limited to instances of special orders for ingot molds required by the receiver's production schedules. According to consignee testimony, railroads cannot effectively participate in the movement, unless their rate

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[1] Rates, costs, charges, and differences therein are stated per gross ton, unless otherwise indicated.

[2] The Pennsylvania Railroad Company (the Pennsylvania) and the Louisville and Nashville Railroad Company (the L. & N.).

[3] Mississippi Valley Barge Line Company (Mississippi), The Ohio River Company (Ohio), and Union Barge Line Corporation (Union).

would not exceed the total cost to the consignee of barge-truck service. As noted above, that cost is $5.11. The present rail rate is $11.86,[4] subject to a carload minimum of 100,000 pounds. The proposal applies to a minimum of 600 gross tons in single shipments, minimum 112,000 pounds per car, on one bill of lading from one consignor at one origin to one consignee at one destination, tendered in one day.

In approving the rate, division 2, noted that—

> * * * protestant bargelines have chosen for some time to forego the revenues of a rate set at a level which would return fully distributed costs. They have done so voluntarily and, considering the rail rate levels and the fact that the traffic has moved almost exclusively by barge since 1953, without being subject to any competitive compulsion insofar as respondents are concerned. * * * From all that appears of record, protestants' choice in setting their rate at the level respondents now seek merely to meet was also reached voluntarily. Such action affords no basis for assuming that the action of respondents in meeting but not undercutting protestants' rate destroys an inherent cost advantage. Indeed, we think it plain that protestants, being in a position of their own free choosing, cannot successfully object to a rate which, we find, will return revenues reasonably in excess of out-of-pocket costs * * *. [323 I.C.C. 758, 763.]

Division 2 then concluded that the rate was compensatory and just and reasonable and not a destructive competitive practice in derogation of the national transportation policy.

The respondents, in their petition for reconsideration, request that division 2's report be modified. They urge

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[4] Conversion to a gross-ton basis of the rate of $10.59 published per net ton, effective in February 1963.

the elimination of a policy statement to the effect that fully distributed costs are adhered to by the Commission in determining the low-cost mode. It is respondents' position that only out-of-pocket (incremental) costs of the proponent carrier should be considered, and that a rate which exceeds such costs is lawful. In their view no reliable intermodal cost comparison can be made and none should be attempted. The protestants, however, argue that intermodal cost comparisons should be made and that those compared should be on the full-cost level.

In their petition, the protestant bargelines argue that the report of division 2 is contrary to the legislative history of section 15a(3) of the Interstate Commerce Act, and cannot be reconciled with any reasonable theory of destructive competition, as reflected in the national transportation policy.

No serious dispute is raised on petition as to the analysis of the cost evidence in the prior report. We adopt such statements therein as our own. The proposed rate exceeds the rail respondents' out-of-pocket cost of 468.9 cents by 42.1 cents. The rail fully distributed cost is 759.4 cents, and the comparable full cost for barge-truck service is 519.6 [5] cents. The proposed rate, which is on parity with the total charges for barge-truck service, is below the rail fully distributed cost by 248.4 cents and below the barge-truck full cost by 8.6 cents.

The protestants contend that the costs of Mississippi are typical of the costs of all barge protestants herein since the cost factors for the different carrier lines are very similar. Mississippi handled 10 of the 19 shipments in the period 1961-63, and we accept the cost figures from its data as representative for our purposes herein.

[5] Includes barge full costs of 340.6 cents, plus the barge-to-truck transfer charge of 95 cents and the for-hire truck charge of 84 cents.

The costs of providing additional services attending the movement of traffic by barge are not shown on this record. Division 2, relying on the Commission's findings in *Sugar, South to Indiana, Ohio River, Intermediate Points*, 319 I.C.C. 782, 784, added the aggregate of such charges to the barge costs in computing the full cost of barge-truck service herein. Under the circumstances here present, we accept the division's computation of barge-truck costs.

Division 2 further concluded that other service considerations of the competing modes were not shown of record to be controlling. We agree that in this context neither mode possesses any material inherent service advantage.

DISCUSSION AND CONCLUSIONS

Simply stated, the railroads are here proposing a rate of $5.11, that meets the charges, $5.11, to the shipper who utilizes barge-truck. The rail rate is below its fully distributed costs of $7.59. The barge-truck charges are below its fully distributed costs of 519.6 cents but, as noted, the barge-truck fully distributed costs are considerably lower than those of the railroads. Under equal charges, rail respondents virtually concede that all of the traffic would move by rail.

Section 15a(3) of the act provides that—

> In a proceeding involving competition between carriers of different modes of transportation subject to this Act, the Commission, in determining whether a rate is lower than a reasonable minimum rate, shall consider the facts and circumstances attending the movement of the traffic by the carrier or carriers to which the rate is applicable. Rates of a carrier shall not be held up to a particular level to protect the traffic of any other mode of transportation, giving due consideration to the objectives of

> the national transportation policy declared in this Act.

As pertinent here, the national transportation policy provides for—

> * * * fair and impartial regulation of all modes of transportation subject to the provisions of this Act, so administered as to recognize and preserve the inherent advantages of each * * * to promote * * * and foster sound economic conditions in transportation and among the several carriers; to encourage the establishment and maintenance of reasonable charges for transportation services, without * * * unfair or destructive competitive practices; * * *.

In *Interstate Commerce Commission* v. *New York, N. H. & H. R. Co.*, 372 U.S. 744, 762 (1963), the Supreme Court observed that—

> The primary reason for the reference to the National Transportation Policy in § 15a(3) was to confirm the Commission's power to protect the inherent advantages of all carriers from destructive competition.

Cost is such an advantage. *Interstate Commerce Commission* v. *New York, N. H. & H. R. Co., supra*, 759.

The importance of this case rests upon the resolve of a fundamental proposition: the criteria for determining how the low-cost carrier's inherent advantages should be measured and protected. Such a determination comprehends a comparison of the cost advantages of two competing modes of carriage. It could not be determined, *in vacuo*, by viewing the operations of a single carrier or mode, as urged by the respondents.

In *Grain in Multiple-Car Shipments—River Crossings to So.*, 325 I.C.C. 752, 772, the Commission recognized that—

> Although the fully distributed cost standard requires an arbitrary assignment of constant costs to

particular traffic, that standard has generally been employed in measuring inherent cost advantages in intermodal competitive rate controversies.

In the prior report, division 2, concluded that—

> * * * whenever [regulated] competitive carriers of different modes assert cost advantages inherent to their respective modes, * * * [the Commission has] recognized in fully distributed costs the only sound standard of measurement reflecting as many attributable constant costs as it is reasonably practicable to apportion. [323 I.C.C. 758, 762.]

We agree. The rail respondents, however, argue against the use of such standard. On reply to protestants' petition for reconsideration respondents urge that—

> * * * a rate is "profitable" if it produces revenues in excess of the incremental [out-of-pocket] costs of providing the service. And a rate achieves maximum profits when the revenues per unit above the incremental cost of producing the unit, multiplied by the units sold reaches the optimum. This in turn depends upon the demand for the service at varying price levels. The optimum price being a function of the varying demand at different price levels, it follows that it may be relatively close to the incremental cost level or considerably above it. But if the price is optimum, regardless of its relationship to a fully distributed cost level determined by a statistical allocation of the constant expenses, it will make the maximum contribution to the pricer's net. * * * the optimum price oriented to the incremental cost as the floor is "fully compensatory" for no other price can produce as great a contribution. Thus, a fully compensatory rate is one which produces the maximum contribution; and for it to be achieved, the only relevant cost level is incremental cost. Within a multiservice industry, it will only be a coincidence, something equivalent to receiving 13 cards of one suit in a bridge hand, where the fully

compensatory rate—if this means the rate producing the maximum profit—happens to equal a statistically determined "fully distributed" costs.

* * * So far as the volume movement of ingot molds is concerned, the single car rate of $11.86 per ton, which existed prior to the reduced rate and still is available, has produced no traffic. While it exceeds the fully distributed cost level, it produces no net with respect to the volume movement of this traffic. Viewed from the railroads' standpoint, it is a "non-compensatory" rate since it generates no profits. By contrast, the reduced multiple car rate of $5.11 per ton will generate a considerable movement of the volume tonnage. If the shipper is to be believed, and the railroads believe him—and the Commission has no reason for doing otherwise—the rail rate must be at this level or lower if the railroads are to haul any of the volume movement. This reduced rate, which amply covers the incremental costs but falls short of the artificial fully distributed level, is therefore not only a profitable rate, but actually the most profitable rate the railroads can charge on this traffic. It is also, therefore, a "fully-compensatory" rate since no other rate would produce as much net.

We do not agree with respondents' arguments that fully distributed costs are an inappropriate or inadequate measure of the inherent cost advantages of competing regulated carriers. That is not to say that fully distributed costs should set the floor for transportation prices. In the setting of particular rates, as where competition from unregulated carriers compels, a carrier should be allowed to set its rates below fully distributed costs. However, merely because a carrier is able, without incurring an out-of-pocket loss, to handle certain traffic at rates below fully distributed costs, and perhaps by diverting sufficient tonnage from its regulated competitors to maximize thereby the contribution that such traffic would make to its overhead, does not necessarily mean that the

carrier is the more efficient of the two. Carriers, such as the railroad respondents, do not, in the circumstances here present, possess an inherent cost advantage within the context of the national transportation policy which the Commission is obligated to recognize and preserve.

Moreover, regulation could neither be fair nor impartial if we did not recognize the fact that the carriers before us do not compete for every type of traffic. It is quite obvious, for example, that the traffic here involved is of far more consequence to the barges than to the railroads. Analysis of 1962 systemwide revenues for the Waterways Freight Bureau's members indicates that iron and steel products, which includes ingot molds, is the third most important commodity group transported in barge service, accounting for 10.81 percent of their total revenue. It is 1 of 11 commodity groups which account for 81.45 percent of the total barge revenue. In fact, the railroads readily concede this point. In short, an inherent cost advantage under the national transportation policy reasonably could not embrace a concept that would impair the ability of a carrier not only to compete but to exist.

In the prior report division 2 concluded that—

> It may readily be inferred that protestants would have raised their rate to a higher level * * * had they themselves deemed it appropriate to protect their inherent advantage. * * * protestants' cost advantage is such that they are in a position to continue to compete effectively and still charge a [reasonable] rate * * *. [323 I.C.C. 758, 764.]

We disagree. To have any validity the concept of an inherent cost advantage must have a definitive meaning. It could not, therefore, be framed within such a relative context, as suggested in the prior report. Either one mode or the other possesses an inherent cost advantage, and

that advantage is not subject to the sport of chance. That is to say, such an advantage cannot be lost merely by the creation, accidental or otherwise, of a rate below a fully distributed cost level. It appears so obvious here, for example, that the barge protestants were not aware of the precise cost level when their present rate was set.

In *Pig Iron, Buffalo, N. Y., to Chicago, Ill., and Gary, Ind.*, 321 I.C.C. 131, 129-130, the Commission, division 2, concluded that—

> * * * the principal purpose of the reference in section 15a(3) to the national transportation policy was to prevent a carrier from setting a rate which would impair or destroy the inherent advantages of a competing carrier, for example, by setting a rate, below its own fully distributed costs, which would force a competitor with a cost advantage on particular transportation to establish an unprofitable rate in order to attract traffic. It is readily apparent that if the reduced rates are approved from the five origins where protestant * * * [barge lines are] the low-cost carrier, any reductions in the water carrier rates necessitated thereby would necessarily be brought to a level below fully distributed cost. Therefore, the reduced rail rates result in a destructive competitive practice in contravention of the national transportation policy since the rates are substantially below the respondents' fully distributed costs and will force the protestant, which has a cost advantage, to establish unprofitable rates in order to remain competitive. This, in turn, would impair or destroy the protestant's inherent cost advantage.

As pointed out in *Interstate Commerce Commission* v. *New York, N. H. & H. R. Co.*, *supra*, 757,

> There can be no doubt that the purpose of this provision [§ 15a(3)] was to permit the railroads to respond to competition by asserting whatever inherent advantages of cost and service they possessed.

In circumstances such as here presented where both the proponent carrier and the competing carrier are regulated, the Commission consistently has utilized the fully distributed cost standard to determine which mode of carriage possesses an inherent cost advantage. *Electric Cable & Wire, Worcester, Mass., to Houston, Tex.*, 319 I.C.C. 390; *Plastics from Texas to the East*, 319 I.C.C. 379; *Frozen Juice and Fruit from Florida to the North*, 319 I.C.C. 577; and *Candy and Confectionery from N. J., N. Y., & Pa. to Tex.*, 321 I.C.C. 154. Under that standard the rail respondents here do not possess an inherent cost advantage.

The propriety of using the fully distributed cost standard and questions respecting the proper construction of costs for the various modes are among the issues in the broad rulemaking proceeding of docket No. 34013, Rules Governing the Assembling and Presenting of Cost Evidence. A radical departure from the fully distributed cost norm as urged by the respondents would not be justified on the limited record here before us, particularly when such issues are to be determined on a comprehensive record in docket No. 34013.

The Supreme Court emphasized in *Interstate Commerce Commission* v. *New York, N. H. & H. R. Co., supra*, that—

> The principal reason for this reference [in § 15a(3) to the national transportation policy], as the hearings show, was to emphasize the power of the Commission to prevent the railroads from destroying or impairing the inherent advantages of other modes. And the precise example given to the Senate Committee, which led to the language adopted, was a case in which the railroads, by establishing on a part of their operations a compensatory rate below their fully distributed cost, forced a smaller competing *lower cost* mode to go below its own fully distributed

cost and thus perhaps to go out of business. [372 U.S., 744, 758.]

On a fully distributed basis, the low-cost mode of transport is barge-truck. We do not agree with division 2's conclusion that the barge "cost advantage is such that * * * [those carriers] are in a position to continue to compete effectively and still charge a rate reasonably in excess of out-of-pocket costs, * * * even if they were to reduce their rates." 323 I.C.C. 758, 764.

Nothing in that report suggests that such a reduction in the rate of the barge-motor lines cannot be matched by successive reductions in the railroad rates. The railroad out-of-pocket costs are lower than the barge-motor lines' variable costs. Therefore, the railroads can wage the rate battle as long as or longer than the barge-motor lines. The rationale of the division's report would permit no ground upon which the Commission would be able to intercede to halt such a devastating rate war. While this may give full rein to the "play of competition," 323 I.C.C. 758, 764, it is difficult, if not impossible, to comprehend how it would accord recognition and preservation of inherent advantages as contemplated by the national transportation policy.

In short, by reducing its rate below the level of the barge-truck full costs, the respondent railroads have unlawfully impinged upon the ability of the barge-truck mode competitively to assert its inherent cost advantage. This action we cannot approve. To hold otherwise we would deprive barges from asserting an inherent cost advantage and we would deprive shippers of cheaper water transportation. Cf. *Interstate Commerce Commission* v. *Mechling*, 330 U.S. 567, 575-579 (1947); *Dixie Carriers, Inc.* v. *United States*, 351 U.S. 56 (1956).

Upon reconsideration, we find the reduced multiple-car rate, minimum 600 gross tons per shipment, on ingot

molds from Neville Island and Pittsburgh, Pa., to Steelton, Ky., unjust and unreasonable, and in contravention of the national transportation policy. The findings in the prior report are reversed.

VICE CHAIRMAN BUSH, dissenting:

Carrier initiated ratemaking innovations, compatible with the requirements of law and practical factors such as numerous and varied present day operational and technological advancements by those subject to rate regulation by us, do not warrant disapproval by administrative fiat. The finding of unlawfulness herein rests, in my view of the record, solely upon an adverse concept, which is contrary to the provisions of the Interstate Commerce Act, as well as Commission and judicial precedent of long standing.

Conspicuous by its *absence* is an important element of proof of the lawfulness of the proposal, particularly in an intermodal rate adjustment, namely: the unrebutted evidence of a competitive necessity, which has been affirmatively shown of record by respondents. Under the facts here presented, I can find no justification for ignoring this essential ratemaking factor of longstanding precedent in making such a determination herein.

Conspicuous by its *presence*, however, is a purely speculative and unprecedented theory wholly without evidentiary support nor cogent supporting reasons, relative to the manner in which cost concepts are applied, allegedly to justify disapproval of the proposal. The determination of the compensatory nature of any rate proposal and of the necessity that it comport with the rule of ratemaking set forth in section 15a of the act, as amended, requires a comparison of like with like factors, rather than the comparison of data incompatible with each other. Admittedly, the involved rail and barge-truck rates are be-

low the fully distributed cost level for the respective modes as is determined herein. Appropriate consideration is then given to a comparison of the proposed rail rate with those costs incurred by the *rail proponents* in accord with our longstanding practice as recognized by all modes of regulated transport. Then, in circumvention of reality and by adoption of a concept of first impression, the determination rests upon the foregoing cost comparison with the barge-truck costs to the *shipper*, rather than costs of the barge-truck movement to such carriers, to prove they possess the inherent advantage of being the low-cost mode of transport. A realistic evaluation indicative of the falsity of such a costing concept for carrier transportation is self evident, for what it costs the shipper to move its traffic are the *rates* of the carrier plus any other additional shipper incurred expense; yet costs to the carrier, in the absence of unusual circumstances not here present, do not constitute the rate paid by the shipper. Were it otherwise, the inherent carrier cost advantage would not be susceptible of reasonable precision but would be a relative concept, determinable solely by presentation of expenses of unregulated noncarriers. Such is not contemplated by any provision of the act nor judicial requirement.

Finally, although it is incumbent upon us to recognize and preserve the inherent advantages, of which cost is only one, possessed by any rate-regulated mode as contemplated by the national transportation policy, it is not within our province to remain oblivious to the bargeline protestants' evidence of their inherent disadvantages due to *inferior service*. Such an admission against interest militates against the finding herein that neither mode possesses any material inherent service advantage, and adequately supports the conclusion that such is inherent in rail service.

Upon consideration of the record in its entirety, I would therefore find the proposal just, reasonable, and otherwise lawful and discontinue the proceeding.

COMMISSIONER FREAS, dissenting:

In *Interstate Commerce Commission* v. *New York, N. H. & H. R. Co., supra*, called *New Haven*, the Supreme Court indicated that "hard competition" was contemplated by section 15a(3), and that we were no longer to be "a giant handicapper." Yet, the majority now holds that a carrier with an inherent cost advantage must, nevertheless, be protected against another carrier which has not been a competitive factor heretofore and which seeks only to meet the going rate on a compensatory basis. If the instant holding reflects any reasoned consideration of "hard competition," it will surely come as a surprise to the successful proponents of both section 15a(3) and *New Haven*.

Moreover, the protection[6] would utilize fully distributed costs to set the rate level. It is one thing to utilize the fully distributed formula to determine the existence of an "inherent advantage" as between unlikes; it is quite another to use it as a pricing floor. In light of the arbitrary aspects[7] of fully distributed costs, I find it hard to square the majority's cavalier acceptance of those costs as a pricing floor with more relaxed and, to an extent, incremental, standards of other formulas. See, e.g., *Animal Feed from Kansas City, Mo., to Chicago*, 325 I.C.C. 147, *Carbon Blacks from the Southwest to Ind., Ohio & Mo.*, 325 I.C.C. 138, and *Aluminum Extrusions from Miami to Chicago*, 325 I.C.C. 188, and the approval given

[6] "Insulation" would be a more apt term.

[7] Including the failure to give effect to public costs. See *Grain in Multiple-Car Shipments—River Crossings to So.*, 318 I.C.C. 641, 682-683, 321 I.C.C. 582, 618-621 (dissenting opinion).

therein to significant departures from past costing practices, the pendency of docket No. 34013 notwithstanding. In essence, the majority's approach is nothing more than a return to the arbitrary percentage differentials struck down in *New Haven*. It is worthy to note, however, that as to a comparable proposal on a substantially similar movement the proponents thereof ultimately prevailed in court. *Pig Iron from Neville Island, Pa., to Louisville, Ky.*, 313 I.C.C. 771 (1961), reversed in *Pennsylvania R. Co.* v. *United States*, 202 F. Supp. 584 (E.D. Pa. 1962).

As I see it, the majority has come full circle to the pre-section 15a(3) days before 1958, and is once again indulging in the arbitrary allocating of traffic among the various modes. It has done so by equating, in effect, fully distributed costs with a profitable rate. However, the protestants, for whatever reason and certainly not because of rail competition, do not realize such costs. In the circumstances, it must be presumed that ingot mold traffic has returned satisfactory profits. Therefore, it is appropriate to ask what, in actual effect, is being protected since as a fact of competitive economic life protestants' advantage has been a mere cipher. Nor can I indulge in the majority's venture into speculation as to the danger to protestants' survival due to the possible loss of this specific traffic. In actuality, it forms a very small segment of protestants' tonnage and revenue. The majority's logic dictates, if the water carriers' interests are to be protected, a raising of their rate and indeed those of all carriers generally to the fully distributed level. Yet, such an approach has never been taken, nor is it readily apparent why this particular area of rate-making should necessarily be singled out for the restrictive embrace of price fixing at a high level. The majority by its own admission refuses to impose it elsewhere, presumably even where unregulated water carriage is involved.

It is indeed unfortunate that the majority has chosen to limit its ratemaking considerations to the inflexible framing of the issues by the parties.[8] One can understand the narrow position taken by the parties for, if fully distributed costs are to set the rate level, the water carriers need rarely fear rail competition. Conversely, if incremental or out-of-pocket costs both measure inherent advantage and set the rate level, relatively few rail reductions would merit disapproval. But ratemaking is not, and cannot be, limited by application of an inflexible mechanical formula. Once it is determined which mode has the low-cost advantage, the effect of a proposed rate must be measured in that light. To limit a proposed reduction in rate to the fully distributed level of another mode, regardless of the level of the other mode's rate or of other transportation circumstances, is patently anticompetitive. It must be determined whether there is room for reasonable competition. The writer so testified on behalf of the Commission in hearings which ultimately culminated in the passage of section 15a(3). See e.g., Hearings Before the Subcommittee on Surface Transportation of the Senate Committee on Interstate and Foreign Commerce on Problems of the Railroad, 85th Cong., 2d sess., pt. 3, at 1884 *passim* (1958). As I understand matters, the Congress nevertheless determined to avoid what is considered to be past inconsistencies by writing a specific provision eliminating some of the supposed previously existing paternalism imposed under section 15a (2). Such action was taken despite the existing requirement in section 15a(2) that consideration be given to the need, in the public interest, of adequate and efficient rail

[8] Such an approach does not, in my opinion, reflect the full consideration of the choice which must be made between different remedies with different consequences to the carriers and the public. *Burlington Truck Lines, Inc.* v. *United States*, 371 U.S. 156, 167-168. See also *Gilbertville Trucking Co.* v. *United States*, 371 U.S. 115, 130-131; *New Haven*, 372 U.S. 744, 763; *Atchison, T. & S. F. Ry. Co.* v. *United States*, 225 F. Supp. 584, 606-607 (D. Colo. 1964).

service at the lowest cost consistent with the furnishing of such service.

Section 15a(3) directs us to consider the facts and circumstances attending the movement of the traffic. If there is room for reasonable competition, then a rate may be approved since the inherent advantage of the low cost of the competing mode will still be preserved. That is, the low-cost mode will still be able to compete. *Accord, New Haven*, 372 U.S. 744, 761, n. 14. Here, the proposed rate meets, not undercuts, the water-truck rate and reasonably exceeds out-of-pocket costs in the circumstances presented. Yet, the water-truck rate can still be competitively reduced if such action proves necessary, despite shipper testimony to the contrary, to participate in the traffic.[9] Indeed, such a reduction, even a small one, would in all likelihood, recapture the traffic since any subsequent rail reduction would probably be noncompensatory. Such a conclusion is evident from a comparison on a hundredweight basis of the rail costs accepted as valid with the rail rate. The water-truck movement, on the other hand, would have lower variable costs if the 90-percent variable figure recently referred to in *Grain in Mutiple-Car Shipments—River Crossings to So.*, 325 I.C.C. 752, 774, n. 11 (1965), for example, is controlling. The statement in the report that the railroad out-of-pocket costs are lower than the barge-motor variable costs is presumably the result of accepting uncritically a variability figure approximating 100 percent for protestants; a figure not conceded by protestants and rightly so since it assumes that equipment is being put to full use all of the time, a millennium few carriers have reached. Apart from the foregoing weakness in the majority's approach,

[9] It should be observed that the conclusion that a reduction by protestants would be necessary to participate plainly implies a service advantage on the part of respondents at equal rates; an advantage which should not go unrecognized.

even a 90-percent figure should no doubt be lower if it is assumed, as it can be, that the truck costs erroneously equated [10] by the majority with the truck charge are, in fact, less than the latter.

Preserving an inherent advantage does not, in my opinion, mean rate stratification. *New Haven*, when read in its proper context,[11] and the legislative history stand for no such principle. The division report reached the correct result on both realistic economic and legal grounds, and, in so doing, properly accommodated the different views of the parties. I would affirm the findings in the report.

I can appreciate a quest for certainty in decision-making but there are no absolutes in the pragmatic, competitive world of ratemaking. By refusing to recognize legitimate commercial objectives, I believe the majority's action invites both reversal in court and legislative action. I am unwilling to assume that the underlying congressional efforts were for nought.

COMMISSIONER TIERNEY, dissenting:

I would affirm the findings in the prior report that the proposed rate is just and reasonable, and not destructively competitive.

The rate maintained by protestant bargelines and at which they transported the traffic over a period of years was not set at that particular level for any competitive reason. Under the circumstances we must assume that such rate was at a profitable level. Therefore, the fully distributed cost level cannot, in this situation, be said to

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[10] See *Eastern Central Motor Carriers Assn. v. United States*, 239 F. Supp. 591 (D.D.C. 1965).

[11] Similarly, a proper reading of the *Pig Iron* case, 321 I.C.C. 121, cited by the majority, will disclose that the proponents there sought to undercut substantially, not merely to meet, the low-cost mode. I submit that the distinction is material.

represent the lowest profitable level since the water carriers were apparently conducting profitable operations (in the absence of competitive rates) at a rate below their full cost of service. Cf. *Interstate Commerce Commission* v. *New York, N. H. & H. R. Co.*, 372 U.S. 744, 759-761 (1963).

In a proceeding of this nature, the proponent of the rate must show (1) its costs, (2) that the proposal is just and reasonable from the standpoint of its own revenue requirements, and (3) that the proposal is not destructively competitive; and the party asserting that it has the inherent cost advantage must rebut the foregoing by showing *(a)* its costs, *(b)* the lowest level at which it may conduct competitive operations and continue to operate at a profit, and *(c)* the asserted differential, if one is necessary, for participation in the involved traffic. Here, the rails, in my opinion, have met their *prima facie* burden with evidence that the rate is just and reasonable and not destructively competitive; and the water carriers have not sufficiently rebutted such evidence. Accordingly, I would allow the public to receive the benefit of hard competition in the situation before us.

While the water carriers are the low-cost mode, there is no way to determine on the evidence of this record the lowest level at which they can effectively compete and continue to operate at a profit. Although the shipper testified of his intent to divide the traffic between the two modes, the respondents and protestants are in virtual agreement that at equal charges the shipper will tender all of the traffic to the rails. Under these circumstances, protestants were remiss in not furnishing us with the above-specified evidence.

The majority's action herein, utilizing arbitrarily the fully distributed cost level of the low-cost mode as a floor below which the high-cost mode cannot go in establishing

a competitive rate on a compensatory basis, in my opinion, is contrary to the legislative history of section 15a (3).

It is ordered, That the respondents herein be, and they are hereby, notified and required to cancel the schedules described in the order entered by the Commission's Board of Suspension on November 27, 1963, on or before January 3, 1966, upon not less than one day's notice to this Commission and to the general public by filing and posting in the manner prescribed under section 6 of the Interstate Commerce Act, and that this proceeding be, and it is hereby, discontinued.

By the Commission.

H. NEIL GARSON
Secretary

(SEAL)

Exhibit No. 37

STATEMENT OF WILLIAM J. BAUMOL

My name is William J. Baumol. I was awarded a degree of Bachelor of Social Science at the College of the City of New York in 1942. I received my Ph.D. in Economics from the University of London in 1949. I am the author of the following books: *Economic Dynamics,* MacMillan, New York, 1951, 2nd edition, 1959; *Welfare Economics and the Theory of the State,* Howard University Press, 1952; *Economic Processes and Policies,* L. V. Chandler co-author, Harper, New York, 1954; *Business Behavior Value and Growth,* Macmillan, New York, 1959; *Economic Theory and Operations Analysis,* Prentice-Hall, Englewood Cliffs, New Jersey, 1961; and co-editor with Klaus Knorr of *What Price Economic Growth?,* Prentice-Hall, Englewood Cliffs, New Jersey, 1961.

I am also the author of numerous articles appearing in such journals as *American Economic Review, Harvard Business Review, Management Science, Operations Research Quarterly Journal of Economics, Journal of Political Economy, Review of Economics and Statistics, Economic Journal, Economica, Econometrica, The Review of Economic Studies and Kyklos,* and am currently an American editor of the *Review of Economic Studies.* One of the articles which I co-authored is *The Role of Costs in the Minimum Pricing of Railroad Services* which appeared in the October 1962 edition of the Journal of Business of the University of Chicago. A copy of this article is attached to my statement.

I taught at the London School of Economics from 1947 to 1949 and since then have been teaching at Princeton University where I am now full professor in the Department of Economics. I have also done some teaching at the University of California at Berkeley and Columbia University. I am a Fellow and Member of the Council of the Econometric Society and have been a candidate for the Presidency.

of the Institute of Management Science (TIMS) in which I currently hold several committee chairmanships. I was at one point president of the central New Jersey chapter of the American Statistical Association.

I have done a considerable amount of industrial consulting both independently and through the consulting firms of Alderson Associates in Philadelphia and Mathematica in Princeton, New Jersey. Among the firms for which I have consulted are The Monsanto Chemical Company, The Anheuser-Busch Brewing Company, Carpenter Steel Company, the Portland Gas Company, the Harvey Leather Company, Meade Johnson and Company, the General Foods Corporation, Morgan, Stanley and Company, and I am currently on an advisory committee to the President of the Prudential Insurance Company. In addition, I have consulted for numerous governmental agencies, including the United States Department of Agriculture and the United States Navy for whom I have worked on problems of transportation. Though my work has primarily centered around liberal arts institutions, I have given guest lectures at a variety of business schools, have been consulted on problems pertaining to their curricula, and have addressed numerous annual meetings of the American Marketing Association and various special marketing groups.

I am co-author of the basic article on economics to appear in the next edition of the Encyclopedia Britannica and am currently in charge of the graduate program in Economics at Princeton University. My books are used in a considerable number of institutions throughout the world and several of them have been translated or are in course of translation.

My industrial experience includes a variety of pricing problems pertaining to different types of industrial operation. For example, my work for the Portland Gas Company and for the Anheuser-Busch Brewing Company was primarily concerned with pricing problems. Transportation problems play a role in several of my writings and appear expli-

citly in my book, *Business Behavior, Value and Growth*, as well as in a paper delivered before the annual meetings of the American Marketing Association in New York City in December of 1961. A very considerable portion of my writings are most explicitly concerned with problems of pricing within the business firm.

Section 1. Introduction

There is no question that cost data are pertinent to railroad pricing and to many regulatory decisions in this area. The type of cost figure which is appropriate for use in this decision process is clear to economists, but it seems to have been beclouded by arguments presented to the Interstate Commerce Commission on behalf of various parties. This exhibit undertakes to explain the conclusions of economic analysis on this matter.

It is important to recognize that the discussion which follows does not represent the views of one or a few economists or even of a narrow school of economic analysts; rather it can be stated without hesitation that it would receive the support of the vast majority of reputable members of the profession. Once they are fully understood, the concepts described can be considered to consist of results fully supported by formal logic so that the fundamentals of the analysis are largely beyond dispute.

This analysis leads to three fundamental conclusions which should be summarized at the outset:

1. That the type of cost datum which is most pertinent and validly employed in the setting of price floors (Minimum rates) is incremental or marginal cost. Artificial concepts, such as fully distributed cost, are irrelevant for the purpose and the use of such measures can impose unjustifiable burdens on the carriers and lead to inefficient utilization of transport facilities.

2. In determining any price floors for the services of a particular carrier, only the incremental costs incurred directly or indirectly by *that* carrier in providing that par-

ticular service are always pertinent. Cost data pertaining to any other carrier or any other services of the carrier in question are irrelevant and lead to decisions which are harmful to the economy as a whole as well as to the individual carrier.

3. Regulation of minimum rates should address itself to the effective prevention of destructive competitive practices. Once having set up an effective machinery for this purpose, it should be the objective of the Interstate Commerce Commission and other regulatory agencies to provide maximal scope for unhampered freedom of decision on the part of the carriers which constitute our transportation industry. For efficiency of the free enterprise system requires that, within appropriate limits, carriers be given the opportunity to exercise their initiative in settling their rates in accord with the profit motive.

The remainder of this statement is devoted to an explanation of the concepts which have just been mentioned and to indicate the rationale which underlies the tenets that have just been enunciated.

Section 2. Incremental Costs - The Cost Datum for Decision Making.

There is a basic parallel in the structure of the objectives which private firms and society as a whole try to achieve through their economic activities. In both cases, their goal is to obtain as large a yield as possible from the limited resources which are available to them, that is, to utilize their economic resources as effectively as possible. But in order to maximize profits, or to maximize the amount of physical transportation achieved, or to maximize anything else, it is necessary in the course of the decision process either explicitly or implicitly to make use of the fundamental incremental cost concept. This assertion is simply a restatement of a fundamental principle familiar to mathematicians and all those, like engineers, who apply mathematics to decision making. In particular, a carrier which is undertaking to maximize the contribution made by its operations to its

profits and the defrayment of its overheads must, in the course of its pricing decisions, utilize data reflecting, as accurately as possible, its incremental or marginal costs; and it must use these rather than some artificial composite figure such as fully-distributed costs. Insofar as the latter is used as a substitute for the former, pricing calculations are likely to involve a loss in profits to the company and a reduction in the efficiency of the utilization of society's transportation resources.

Though the concept may at first appear to be relatively complex and abstract, the notion of incremental costs is really rather simple, and the reason why it is pertinent is not difficult to follow.

It may be noted that the incremental cost concept is not dissimilar in principle from what the Cost Finding Section of the Interstate Commerce Commission refers to as out-of-pocket costs. Thus, in Statement No. 7-63, "Explanation of Rail Cost Finding Procedures and Principles Relating to the Use of Costs" (November 1963), the Cost Finding Section states:

> "These 'out-of-pocket' costs are sometimes referred to as added traffic costs, marginal costs, direct costs, assignable costs, separable costs, traced costs, or prime costs. Whatever the term used, the figures have reality in rate making only to the extent that they reflect the added costs which were incurred because the traffic in question was handled, or the costs which could have been avoided if the traffic were not handled." (p. 3)

Let us examine precisely what is meant by *incremental costs* and indicate how they are measured. The incremental costs of any output or service is defined as the addition to total cost which is incurred by any unit of that output or service (where this cost is measured per unit increase of that output). For example, if a railroad could save $120 by means of a 1000 ton-mile reduction in the amount of some product it carries, it is clear that the 1000 ton-miles carried was responsible for an increment in its total cost.

amounting to $120. This means that the incremental cost is $120 divided by 1000 or 12 cents per ton mile. Of course, this figure applies equally to *any* 1000 units of this particular traffic having the same transportation characteristics. Since the railroad can reduce its outlays by $120 through the elimination of *any* 1000 ton miles of this traffic, the same incremental cost figure and, hence, presumably the same price pertains to any such portion of that traffic.

It is important to notice that this concept concerns itself in principle with current and potential costs of operation, outlays over which the actions of management can have some influence. It wastes no time on sunk cost figures drawn from ancient history which are beyond anyone's control, but inquires instead how much must be spent in order to make it possible to continue the provision of that service so long as a profitable market remains available.

How then does the incremental cost concept enter the decision process? As already indicated, it is a necessary tool of any maximization calculation. Maximization of profit, for example, requires the decision maker to take advantage of every opportunity to add to the net returns of the company. It costs a railroad money if it neglects an opportunity to establish a rate reduction which will generate new traffic of a type not presently being handled providing revenues in excess of the added costs incurred by supplying that output. Similarly, it costs a railroad money if it fails to establish a rate reduction which will generate additional traffic of a type being presently handled, if the total amount to be realized above the incremental costs of transporting the larger volume will exceed that realized from the smaller volume being presently handled. The outputs and rates of a railroad can only be optimal from its own point of view if no change in either of these variables will *add* more to revenue than it does to costs. That is, to test whether we have achieved a maximum, we must compare *incremental costs* with incremental revenue. It is impossible to achieve a maximum without taking advantage of every possibility

which offers an incremental revenue greater than the corresponding incremental cost. Exactly the same principle applies to decisions designed to maximize the welfare of society or to any other maximization calculation.

If any floor on rates, other than that provided by incremental cost is artificially imposed by regulatory decisions, both the public and the business firms involved must necessarily be harmed. The public must suffer because of the lost opportunities to obtain goods and services whose value exceeds the added costs incurred. The participating carriers must lose because they are forced to forego opportunities to supply services which could have provided a contribution to profit and overhead, that is, whose incremental revenues would be greater than their incremental costs.

Section 3. **Incremental Cost as an Appropriate Floor for Railroad Rates.**

It is surely socially desirable in itself to have service provided to the public at prices as low as is possible. This is inherent in the basic logic of the competitive process and the reason why it has received such wide approbation. In general therefore, it would seem appropriate to encourage rate reduction in transportation and, from the point of view of society, the burden of proof would appear to rest on those who would seek to prevent it. Indeed, there appears to be only one good reason justifying the imposition of a floor below which rates are not permitted to fall. This purpose is, of course, to prevent any carrier from pricing at a level so low that its operations would not be viable and where the sole purpose of such a noncompensatory rate is to drive out competitors. There is much to be said for prevention of this sort of destructive competition, and data reporting the costs of a carrier can be of some help in its prevention.

In the determination of any minimum rate to be used for such purposes, incremental costs are of unique significance. First of all, any carrier which charges a rate that is below incremental cost is necessarily making a sacrifice of its profit and, as it were, providing a loss leader to the users of

its services. Any continuing operation of this variety must constitute a cumulative drain upon the carrier's resources. Thus, any such price arrangement may be taken to constitute evidence of predatory pricing.

On the other hand, where a particular rate exceeds the corresponding incremental costs, it cannot be legitimately argued, on the basis of cost considerations, that it is designed as an instrument of destructive competition. Carriers will frequently find it profitable and natural to supply services at a rate which yields only a small margin above incremental costs. Since some addition to profit is always better than none, a railroad cannot, in self interest, refuse to undertake any services for which it will obtain the requisite purchasers at a rate which is slightly above incremental cost, and the failure to supply such a service can only be interpreted as a deliberate sacrifice of profits. Thus, contrary to what is sometimes alleged, freedom to charge prices based on incremental costs can *aid* firms to recover their overhead costs. If a company cannot recover its costs when its prices are set so as to maximize its profits, no substitute pricing gimmick can enable it to cover these costs.

It follows therefore that if costs were to be used as a criterion for rate regulation, only incremental costs can provide an appropriate floor for rates. Any floor higher than this must inevitably force carriers to lose potential profits and potential business.

Moreover, it must be emphasized again that any price floor which exceeds incremental cost can redound to the disadvantage of the entire economy by preventing the supply of useful services whose value to the members of the community exceeds the resources cost incurred in providing them. It is important to note, however, that this only requires the floors, and not necessarily the rates themselves, to be equal to incremental costs. The actual rate should normally be expected to exceed incremental costs by varying amounts whose magnitude depends upon the state of demand.

Section 4. Whose Costs Should be Used in Determining Price Floors?

Some persons have apparently been attracted by the idea that in setting minimum rates the costs which are relevant are not those incurred directly or indirectly by the carrier itself but are instead, at least in many cases, the costs of some other competing carriers. Typically this position has been associated with the phrase "cost of the low cost carrier." Behind such a view, there must lie reasoning such as the following: any rate which does not permit the viable and continued operation of the least expensive of a group of competitors must surely be destructive in effect, even if not in intent. But such an argument employs dangerous and misleading over-simplification. For example, it neglects the fact that one company may successfully out-compete another not because of its lower level of costs, but because of its superior product or its superior services, or because it makes possible a lower overall transportation expense to the shipper.

This line of reasoning has been used to support regulatory policies which are economically unacceptable both because it is impossible to implement even their own peculiar logic and because such policies can impose a heavy burden of inefficiency on the nation's transportation system.

It is impossible to implement a policy calling for rate regulation on the basis of the costs of "the low cost carrier" because there is no valid procedure which can identify the carrier whose operating costs are lowest. The costs of different modes of transportation are characterized by vast structural dissimilarities which for all practical purposes rule out meaningful comparison. For example, there is wide variation in the extent to which they make use of public facilities and thereby impose very real and significant costs on society—costs that are at best very poorly indicated by their accounts. In addition, the cost figures of one transportation mode may be becouded by interfirm relationships, thus making it difficult to determine what are its actual costs of providing the

service being priced. Where this situation exists, comparison of the costs of different modes is likely to be neither precise nor accurate. Moreover, as already indicated, a carrier may possess significant and relevant "inherent advantages" which encompass not only its operating costs but also the superior service which it provides to its customers and the savings in production and shipping costs which it makes possible for them. Such heterogeneous advantages can neither be evaluated nor compared by accounting methods or statistical techniques except after they have been tested by consumer demand. In sum, it is impossible to arrive at any acceptable comparison of the costs and advantages of the costs of different sorts of carrier. As a result, there is no way to implement any policy which attempts to set rates in terms of "the costs of the low-cost carrier" except on the basis of data that are arbitrary and that offer no valid information about the magnitudes which they purport to describe.

Equally important, any such policy can only serve to subvert a fundamental feature of any rational system of ratemaking which must take full account of the costs incurred by the carrier whose rate is under consideration, including, of course, public costs or costs borne by other firms associated in the operation. We have already seen that maximum profitability and optimal utilization require a calculation involving the incremental costs of the supplier. It follows at once that if these incremental costs of the supplier himself are neglected in the calculation, optimal results will be precluded. Not only will the carrier be forced to forego profits, but also, from the social point of view, inefficient use of the resources must be the inescapable result.

A system of regulation which bases the rates of carrier A on the cost of carrier B effectively disrupts the competitive process and its economic test of the efficient use of resources completely. It prevents the individual carrier from setting rates in accord with the profit motive so as to obtain any traffic whose incremental revenue exceeds its incremental cost. So long as its own costs are such as to per-

mit a profitable expansion of its traffic by means of a reduction in price, a carrier should be encouraged to undertake it regardless of the costs of its competitors.

By basing the rate of a carrier not on its own costs but on those of its competitors, an important source of motivation for improved efficiency of operation is eliminated. If reductions in its own costs of operation are not permitted to reflect themselves in reduced rates and thus in increased saleability of the service, there is that much less reason for concern with efficiency. Indeed, such a pricing procedure effectively protects the inefficient carriers who are otherwise unsuited to provide the services concerned. Moreover, it protects the latter at the expense of their more efficient competitors and of the body of consumers whose well being must surely be affected.

In sum, a regulated price calculation which bases the rates permitted one carrier on the costs incurred by another is absolutely indefensible in terms of economic analysis. It can lead to serious inequities and inefficiencies. This is true whether the cost calculation for the rival carrier is based on fully-distributed cost, out-of-pocket cost, incremental cost, or any other cost concept. The price charged by A should never be prevented from being lowered by any cost incurred by B, however appropriate the type of cost figure employed may be for other purposes. Logic and the desire for efficiency dictate that any restrictions on the prices or rates charged by any carrier be based only on the cost (and, it may be added, only on the incremental costs) incurred by that carrier itself.

Section 5. Objections to Fully-Distributed Cost Figures as Guides to the Setting of Mimimum Rates.

The position taken here is basically at variance with the view advocated in a number of quarters as to the appropriate cost concept for use in setting floors to the rates charged by carriers. It is proposed by some that a measure generally referred to as fully-distributed cost should guide regulatory agencies in their determination of rate minima. The

fully-distributed cost is a concept which has long been rejected by economists who have dealt with a similar measure under a slightly different name, "full cost." Economists have pointed out that the concept suffers from a number of fundamental deficiencies. Two of the most important of these are relevant here: its arbitrariness, which means that no full cost figure can be constructed in an unambiguous and fully justifiable manner; and second the fact that this cost concept is totally irrelevant to most optimality computations.

We have already seen why incremental cost, rather than some other cost figures, lies at the heart of any calculation which seeks to arrive at optimal decisions. Fully-distributed costs cannot tell the carrier whether it would gain or lose from raising or lowering rates or by increasing or decreasing its sales volume. Thus, in the normal course of business decision making, where the range of alternatives being considered ordinarily involves these possibilities, incremental cost figures usually provide all the pertinent cost information.

We have seen also how, in setting a price floor, the relevant question as far as costs are concerned is whether the contemplated level falls short of or exceeds incremental costs. This remains the crucial issue for the reasons which have already been given, regardless of the magnitude of fully-distributed costs. For carriers which charge a rate below incremental cost cannot normally be doing so in the pursuit of profit; whereas rates which offer any margin over incremental cost can be expected to occur in the normal operation of any carrier. It is for these reasons, then, that incremental and not fully-distributed costs are the costs which are pertinent to a determination of minimum rates.

As stated, the fully distributed cost concept is also objectionable on the ground that it is essentially arbitrary. In order to apportion fully the costs incurred by a carrier among the various services which it supplies, as is required by the full-cost concept, it is necessary to employ proce-

dures for which there can be no rationale except the fact that they yield numerical results. For in most normal economic operations, one encounters important classes of joint and common costs, that is, costs which facilitate the supply of two or more different types of service. For example, costs which are incurred in supplying both petroleum products and natural gas are of this variety because the outlays which are necessary to produce one of these products automatically facilitate the provision of the other. Similarly, in laying a track which will be used to transport one product, one automatically makes it possible to transport others as well; and in moving a train from source A to destination B, one makes it easier to move goods in the opposite direction. Such joint or common costs therefore are frequently encountered in industry as a whole and especially in transportation. And by the very definition of the fully-distributed cost concept, such joint or common costs must be fully apportioned among the services concerned in any fully-distributed cost figures. But by their very nature, such joint and common costs are not fully traceable among the services to which they pertain. Since these costs simultaneously serve a multiplicity of purposes, there is no way of saying in any valid sense what proportion of the cost appertains to any one of the services involved.

Eloquent testimony to the arbitrariness of the concept is provided by the wide variety of procedures which may be employed in making such allocations. They may be allocated in proportion to the volume of the revenues obtained from the services; in proportion to the out-of-pocket costs which they impose; or they can even be allocated equally among these various pertinent services. Economists agree that there is nothing inherently more correct in any one of these methods of allocation than in any other and that any price floor which is based upon such an arbitrary choice of allocation procedure must therefore, in the last analysis, be considered capricious.

It is to be emphasized that fully-distributed cost floors encourage the inefficient use of resources. They prevent

the utilization of facilities which might otherwise be usefully and profitably employed because their services can be sold at prices which exceed their incremental costs. Fully-distributed cost prices can also discourage modernization of equipment. For the accountant's conventional depreciation figure is normally subtracted from the sunk costs which are "fully-distributed" among the various segments of the carrier's operation. Since ancient pieces of equipment are usually largely depreciated, they place less of a dead weight burden on the pricing of items utilizing the services of such old and obsolete facilities.

Similarly, minimum rates based on fully-distributed costs constitute a drain on the carrier by preventing it from setting rates in accord with normal competitive principles. Such floors preclude the carrier from setting rates which maximize the contribution of each operation to company profits and overhead for they can prevent management from participating in the supply of some services which can yield returns in excess of their incremental costs and which are therefore capable of adding to the financial well being of the carrier.

Fully-distributed cost rates may not even succeed in attaining the objective which they may seem at first glance designed to achieve. Such rates cannot prevent a carrier from losing money because a rate sufficiently high to cover a calculated fully-distributed cost may effectively serve to deprive the carrier of the traffic on which the cost calculation was based. That is to say, if fully-distributed cost is calculated on the assumption that annual traffic will be T ton miles, the price needed to cover that fully-distributed cost figure may be so high that traffic proves to be substantially lower than T. And, as a result, costs per unit may turn out to be far higher than originally anticipated.

Finally, as I stated on another occasion, it should be recognized that fully-distributed cost floors to pricing essentially constitute a price support device and, thus, like any other such measure, fully-distributed cost price floors are directly

inimical to the interests of consumers. It is surely a delusion that the consumer can be protected by forcing him to pay prices higher than he would otherwise have done. It is a standard fallacious argument, whose ubiquity is not entirely accidental, which holds that the survival of a large number of firms is necessary to maintain competition, even if this must be done by means of artificial price supports. Clearly, such an arrangement retains the outward forms of competition and in the process destroys its benefits.

Section 6. **The Regulation of Destructive Competition.**

In sum, fully-distributed cost floors constitute an ill-conceived means for the prevention of destructive competition. We have already seen that price floors based on incremental costs do provide a substantial measure of protection in this matter. There is also another mechanism which would serve as a powerful device for dealing with the problem. Destructive practices can only be attractive to those who instigate them if the high prices which they intend to charge after they have eliminated their competitors are not somehow prevented. The appropriate way, therefore, to preclude such activity is to preclude its rewards. This could be accomplished by a requirement that a firm that initiates a price reduction may not raise its prices again unless such an increase is based on changed conditions other than the modified competitive situation—in other words, by letting a reduction in price constitute evidence that the firm can continue to operate viably at these lower rates in the absence of modified circumstances. The company would thereby be given notice that any price reduction must be fully justified in terms of its cost structure. For if in these circumstances it sets a price which is not viable and is forced to adhere to that price so long as its cost structure remains unchanged, it would suffer the appropriate consequences.

To summarize then, there is no justification for the use of artificially imposed price floors. While in the past some firms have been sufficiently ill advised to attempt to drive competitors out of business by means of temporary low and

noncompensatory prices, an artificial price floor set anywhere above the level of incremental cost is not called for as a means of dealing with such abuses. Rather, they can be prevented effectively by taking the profits out of such predatory acts and, if necessary, by the use of incremental cost floors to the pricing of the services concerned.

Section 7. **Economic Analysis and Incremental Cost Pricing.**

It has been stated at several points in this testimony that the views expressed are based on analytic materials whose validity is accepted by all economists of repute. The evidence on this point is so overwhelming that it requires no documentation. Any standard textbook chosen at random will indicate unambiguously the crucial role assigned to incremental costs in the pricing process.

Moreover, the fallacies inherent in fully-distributed cost pricing have long been known to the profession. This is nowhere better illustrated than in the following quotation taken from the writings of Gustav Cassel, a Swedish economist who, in the first decades of the century, was one of the world's most noted members of the profession. It should be observed that this passage, which so beautifully describes the pitfalls in the full-cost-pricing argument, was published in 1900. Cassel's discussion, which is summarized in tabular form below, is contained in the following admirably lucid statement:

> "Let us suppose that a travel agency has ordered special trains for a number of Sundays and has contracted to pay 250 *mark* for each train. Each train was was to provide 400 seats, all third class. The first Sunday the agency charged 2 *mark* and 125 excursionists bought tickets. The gross receipts amounted to 250 *mark* or to exactly as much as the outlays. The managers of the agency then said to themselves: 'at this price we can only just cover our own costs, but we must also earn something,' and they raised the fare to 3 *mark*. On the next Sunday only 50 people bought tickets. The result was takings of 150 *mark* and a net loss of 100 *mark*. The agency then

reasoned: 'average costs amount to 5 *mark* per person and we carry each passenger for 3 *mark;* we cannot go on like this.' The price was raised to 6 *mark* with the result that on the next Sunday the train carried only 6 passengers. The loss rose to 214 *mark.* Now at last the managers of the agency said to themselves: 'this story of costs must be sheer nonsense, for it only ends in losses.' So they reduced the price straight away to 1 *mark.* The result was brilliant: 400 passengers turned up the next Sunday, a profit of 150 *mark* was earned and, strangest of all, costs had fallen to 0.625 *mark* per head."

It would be difficult to find a clearer explanation of the fallacies inherent in the view that fully-distributed cost pricing can guarantee the profitability of a carrier. This passage also suggests how long and how widespread has been the acceptance among economists of the principles described in this testimony.

TABLE I

CASSEL'S FULLY-DISTRIBUTED COST EXAMPLE (1900)

Total Cost	*Fare* (Mark)	*Number of Passengers*	*Fully Distributed Cost* (Mark)	*Profit or Loss* (Mark)
$250	2	125	2	0
250	3	50	5	-100
250	6	6	42 (Approx)	-214
250	1	400	0.625	150

SOURCE: Gustav Cassel, "The Principles of Railway Rates for Passengers," *International Economic Papers,* No. 6., translated from *Archiv für Eisenbahnwesen,* 1900.

Section 8. Summary and Conclusion.

The preceding analysis sets forth in outline the logic of the relationship between costs and calculations pertinent to the setting of minimum rates for railroad services. It has been shown that the only costs which are always pertinent

to the pricing of the services or of any carrier are the direct or indirect costs of that carrier itself. Second, it has been shown that the appropriate cost concept is incremental cost and not fully-distributed cost or any other such arbitrary construct. Third, it has been argued that minimum rate floors which violate these two pinciples impose burdens upon consumers, reduce the earnings of the carriers, lead to the inefficient utilization of resources and, in general, interfere with the workings of the free enterprise system.

It can never be denied that some regulation of business practices is necessary to prevent occasional abuses. But, surely, it is desirable that these regulations restrict themselves exclusively to the elimination of those abuses. Our system of private enterprise requires that management be given as much scope and freedom for its decisions as is consistent with the prevention of untoward activities. In the case of railroad rates, there is every reason to believe that the interest of society and the economy would best be served by permitting the carriers to lower their rates whenever this is required for the maximization of profit subject only to the limitation that these rates never fall short of incremental costs and that temporary rate reductions designed to destroy competitors be precluded in the manner already suggested. It appears clear that no other restrictions on rate reductions are normally justified.

THE ROLE OF COST IN THE MINIMUM PRICING OF RAILROAD SERVICES

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THE ROLE OF COST IN THE MINIMUM PRICING OF RAILROAD SERVICES

[*Editor's note.*—Over the past fifteen years, settled patterns of regulation of transport rates and services have been subjected to increasing scrutiny and criticism not only from academic economists but also from producers and users of transportation, public officials, and the public in general. The largest single reason for this heightening of interest has been the increasingly severe competitive and financial position of the railroad industry. While the operation and regulation of any one mode of transportation cannot be considered in isolation, much of the present discussion of transport regulation properly centers on the railroads. An important topic has been the search for regulatory principles and procedures which would yield the maximum public benefit from railroad plant and technology under present competitive conditions.

The following statement was prepared under the auspices of the Association of American Railroads, an obviously interested party and one that has done much to stimulate broad interest in the regulatory problems of its members. The statement represents a consensus of ten economists, most of whom will need no introduction to readers of this *Journal.* It is published here as a contribution to the discussion of the business and regulatory economics of transportation and of other industries, both within and outside the public utility field. Specifically, the panel of economists undertakes to clarify the economic principles of costs that are relevant as a guide to the pricing of particular railroad services. The statement, concerned with basic concepts of costs, should help to provide an essential groundwork for the development of improved techniques for the measurement of relevant costs in specific situations.]

FOREWORD

Recognizing the growing attention to cost considerations in railroad rate-making, the Board of Directors of the Association of American Railroads requested Burton N. Behling, Economist, Bureau of Railway Economics of the Association, to arrange for a study of the relevant concepts in determining cost floors for rates and to seek the advice and

counsel of a group of outstanding and disinterested economists in this matter.

To collaborate with him in this undertaking, he engaged the following distinguished consultants:

William J. Baumol, professor of economics, Princeton University, and member of Mathematica

James C. Bonebright, professor of finance, emeritus, Columbia University

Yale Brozen, professor of business economics, Graduate School of Business, University of Chicago

Joel Dean, professor of business economics, Columbia University, and economic consultant, Joel Dean Associates

Ford K. Edwards, transportation consultant, Edwards and Peabody

Calvin B. Hoover, professor of economics, Durham, North Carolina

Dudley F. Pegrum, professor of economics, University of California at Los Angeles

Merrill J. Roberts, professor of transportation, Graduate School of Business, University of Pittsburgh

Ernest W. Williams, Jr., professor of transportation, Graduate School of Business, Columbia University

They began their task early this year, and the results of their work are now presented in the attached statement entitled "The Role of Cost in the Minimum Pricing of Railroad Services." All the participants "subscribe to it in substance and they specifically agree with the conclusions as set forth in the summary at the end of the statement."

ASSOCIATION OF AMERICA RAILROADS
WASHINGTON, D.C.
July 27, 1962

INTRODUCTION

Increasing competitiveness in transportation has stimulated debate regarding the principles which should guide the determination of any floor below which particular railroad rates will not be permitted to fall. A central issue in this debate is whether particular rates should be cost or market oriented. This statement examines the issue—bringing to bear accepted principles of economics that apply throughout the economy. It sets forth the role of cost in pricing and in so doing shows that prices must be *both* cost and market oriented.

Examining first the basic cost concepts and then the nature of railroad costs, the analysis concludes that incremental costs provide the valid cost guide for minimum pricing and that "fully distributed" costs must be rejected as an economic test of any particular price or rate. These conclusions are reached by reference to the interest both of the pricing carrier and of society as a whole, and they have the same force and relevance for pricing within modes of transport as among modes.

UNDERLYING COST PRINCIPLES

The increase in total costs resulting from an expansion in a firm's volume of business is commonly referred to as *incremental cost.* This cost is of vital economic significance. For the businessman it provides an essential guide to his production and pricing policy. If he is considering a reduction in price, he needs to know whether the increase in total revenues from greater volume will more than cover the additional costs that will be incurred. For the whole economy it is incremental (not fully distributed) cost that is the relevant cost guide to how much of what shall be produced and how much should be invested in various lines of production. This cost, which is measured by the value of the additional resources that will be used up when more of anything is produced, represents the real cost to society.[1]

[1] Social costs which are escaped by the enterprise must also be included in the calculation.

Incremental costs indicate (by comparison with the incremental revenues they will bring) whether additional outputs of any commodity are worth producing and (by incremental cost comparisons) which of the alternative ways of satisfying wants or requirements is the most efficient.[2]

But not all costs can be identified causally with specific quantities of production. Much of the controversy over cost concepts stems from the false notion that all costs can be traced and attributed to specific blocks of output. Although many costs are *traceable,* there are also *non-traceable* costs which simply do not lend themselves to this method of identification:

a) Fixed costs.—Some costs, called *fixed costs,* do not change in magnitude when the quantity of output for a given plant varies. Hence, it is impossible to assign any specific portion of these costs to a particular unit of output (e.g., to a particular ton-mile of traffic). Rather, a fixed cost must be imputed to the entire supply of the type or types of service with which it is associated.

b) Joint costs.—Different services may sometimes share their costs, as, for example, when the same roadbed is employed to transport both food products and lumber.

Such common and joint cost conditions are frequently encountered in the railroad industry as well as elsewhere. Wherever incremental costs are also either joint or common costs, the resulting difficulties of allocation cannot be sidestepped. Here the standard distinction between common costs and joint costs can have practical importance. *Common costs* are outlays devoted to either of two or more classes of services which may be variably proportioned at the discretion of management, with the result that it is, in

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[2]In addition to those costs which vary with rate of output for a given investment level, incremental costs include cost increments associated with new investment. For example, if special equipment is acquired in order to handle certain additional traffic, the costs are incremental to that traffic.

principle at least, possible to trace them to individual services. *Joint costs,* in contrast, are costs for which the proportions of output are not variable, so that supplying one class of service in a given amount results automatically in making available another class of service in some unalterable amount. The practical consequence is that incremental joint costs are not traceable to individual railroad services and can be allocated only arbitrarily. In contrast, those common costs which are incremental are traceable in principle, although it may be impossible over a considerable range to do so in practice.

For any business or industry there is no rigid division between variable costs and fixed costs. Some cost elements which are fixed in the very short term or with small changes in output may over a somewhat longer period or a broad range of output become incremental if additional investments or other inputs are required. However, an indefinitely long-term view of incremental costs is not appropriate, for some fixed costs may be expected to remain fixed over any time period and range of output that is reasonable to consider in setting a price floor. Depending on the particular circumstances, incremental costs might contemplate a range of short terms. The only general rule for deciding which measure of incremental cost to use as a *cost* guide for minimum pricing is that the choice of incremental cost functions must be geared to the duration of the expected revenue change.[3]

Each particular situation requires its particular cost analysis by management. For example, a cost structure will be affected significantly by the extent of unused capacity in the production factors involved. Where unused capacity is substantial and persistent, the fixed cost elements per unit

[3]More specifically, the decision is governed by such revenue dimensions as the nature and amount of the contemplated change in volume, the length of the commitment to carry the traffic, the duration and geographic scope of the changed rate, the alterations of the service that might require added investments, and the time period in which changes may legally or practically take place.

of output are correspondingly greater and more enduring, and the incremental costs proportionately smaller.

Arbitrary apportionments of non-traceable costs among particular kinds of outputs must be employed in the calculation of "fully distributed costs." This measure will be further considered later in particular reference to railroad rate-making. However, it is apparent from what has been said that fully distributed costs have no true economic content because their derivation falsely assumes that all costs can be traced to particular kinds or quantities of output and can rationally enter directly into pricing decisions. The greater the degree of non-traceable costs, the more inappropriate is the use of fully distributed costs as a guide to minimum prices.

NATURE OF RAILROAD COSTS

Fixed costs, which are independent of volume and are not attributable to specific amounts of traffic, are an important characteristic of railroad cost structures. Large portions of railroad investment costs represent expenditures for long-lived facilities that have been "sunk" in the enterprise at various times in the past. The facilities involved are of such specialized nature that they are not generally transferable to other pursuits without great loss. Fixed costs associated with sunk physical investments, as well as organizational or other cost factors which are underutilized, are irretrievably committed to an essential public service unless disinvestment, organizational shrinkage, or, as a last resort, abandonment occurs.

Because of the long but varied lives of their facilities and the inherent uncertainties of forecasting, adjustment of railroad capacity to charging requirements is difficult. Unutilized railroad capacity is a chronic problem which demands effective steps to retain existing traffic and to attract additional traffic. Moreover, railroad investments in recent years which were intended for modernization and greater efficiency have in many instances also increased capacity, although this has not usually been the purpose. Significant techno-

logical improvements include heavier rail and track structures, electronic yards, centralized traffic control, and better communications, as well as improved locomotive power and higher-capacity freight cars. Realization of the potential economies of these and other interrelated improvements depends on large and increasing traffic volumes.

The railroads own, and hence must fully pay for, the costly plant facilities they use. In contrast, highway, water, and air carriers use publicly owned rights of way and facilities. To the extent that they repay the economic costs of these facilities furnished to them, their payments are mainly through use charges which make their costs of this sort predominantly variable. For these and other reasons, these rival carriers can adjust their capacities to fluctuating demand more promptly and precisely than can the railroads.

The rapid growth of electrical utility volume has been due to a steady reduction of real prices on average and to promotional pricing designed to utilize capacity effectively and to expand sectors of demand that are price-elastic. These achievements have been made possible, on the cost side, by sustained technological progress and economies of scale in the generation and transmission of electricity and, on the demand side, by strong markets and commendable regulatory insight. This kind of economic performance, generally regarded as serving the public interest, is no less socially desirable for the railroads. And even though it is more difficult to attain because of their highly competitive environment, such performance is at least equally urgent because of the railroads' financial plight.

The public interest requires maximum economic utilization of the vast capacity of the railroads' plant and operating organization. To this end it is essential that the burden of fixed costs be spread over as large a volume of traffic as can be developed with attractive rates in excess of the relevant incremental costs. This mode of operation is desirable not only for the railroads in providing them with the opportunity for reasonable investment returns. It may also

be advantageous to the shippers in lower shipping costs. Above all, it is in the public interest because it provides the maximum amount of transportation service for the resources which are employed for this purpose.

RELEVANT INCREMENTAL COSTS

In determining incremental costs, it is necessary to distinguish between sunk and prospective investments. Sometimes the pertinent incremental costs involve making added investment (e.g., cars or locomotives). In that event all the added costs to be incurred (including use-depreciation and cost of capital) should be recognized as incremental. Sometimes capacity is so excessive that the traffic at issue can be handled without added investment. The investment costs then are sunk and may become fixed for long periods. Once the commitment has been made, and if a plethora of capacity subsequently develops, the recovery of anything more than incremental cost is better than nothing.

Prudent railroad management should certainly be aware of the threat to long-term profitability, and even survival, from fixing rates on a substantial proportion of traffic near strictly short-term incremental costs. Nevertheless, in the complex and varied circumstances of the railroads, there will be some situations where pricing of particular services on the basis of short-term considerations will improve utilization and will yield accretions to net income not otherwise obtainable. In view of their primary responsibility to make effective use of their vast facilities through volume retention and developments, railroad managements require considerable latitude in estimating relevant costs as well as in pricing decisions. There is no single cost formula which will always and automatically be appropriate.

In rapidly expanding industries operating with short-lived facilities and highly flexible organization, recognition of the transitory nature of fixed costs and their tendency to be transformed rather quickly into incremental costs is an essential costing precept for pricing purposes. But railroad costs cannot be cast in such a simple mold. The reality of

their fixed costs cannot be made to disappear with a general assumption of variability with traffic volumes if the time period is stretched out long enough. With the persistent and serious under-utilization of capacity which is characteristic of the railroads' basic plant and organization, large amounts of fixed costs remain fixed indefinitely. The least effective way to cope with unutilized railroad capacity would be to include its fixed costs in floors for pricing. For the high prices which would result could only discourage utilization of these facilities and aggravate the condition.

Neither extremely short-run nor extremely long-run incremental cost is an economic concept of general applicability to all minimum pricing problems encountered in the railroad industry. The determination of the relevant incremental costs appropriate for a particular pricing decision is not simple[4] but must reflect complex railroad cost conditions that arise from persistent excess capacity, irrelevant fixed-cost elements, and such interrelated dynamic factors as changing volume, changing labor and material costs, technological innovations, and improved operating techniques. Where such dynamic forces are at work the incremental costs of additional traffic, which may be induced by a reduced rate, may be quite different from those indicated by past experience.

[4] The relevant incremental costs are a function principally of the prospective volume in relation to present volume and utilized capacity in existing plant and organization. The rate over time at which the prospective volume is likely to be achieved, the prospects for its continuance over the longer term, and its distribution over stated time periods (for example, seasonality and peaking characteristics) are all relevant to the determination of appropriate incremental costs. From consideration of the prospective volume and its characteristics it may be feasible to estimate those elements of plant and organization which will require ultimate replacement, allowances for the use of which should figure currently in costs. If volume promises to build up substantially over time, the likelihood and cost of the required expansion in capacity must be recognized in the computation of the price floor.

More penetrating analysis of specific cost elements is needed for a better understanding of their relationship to traffic volumes. Such analysis, which is beyond the scope of this statement on cost concepts, should be intensified by the railroads. Particularly urgent is the need for cost determinations which are "tailored" to specific situations instead of the commonly used general measures which are vitiated by excessive averaging.

COSTS AND PRICING

Forward-looking costs are essential because the pricing decisions they must guide necessarily look to the future. The estimation of such costs must reckon with changes in operating techniques which may result from expanded volume and associated or unassociated technological innovations. Because of these factors, historical experience provides no sure basis for determining those future incremental costs which alone are relevant in setting price floors.

As a general rule, any rate below incremental costs is both unprofitable and socially wasteful of resources because the additional (incremental) revenue obtained is less than the additional cost incurred.[5] However, this does not mean that the railroads should set rates *at* that cost level or that they should be required to do so. On the contrary, this cost reference is uniquely important as a guide in determining the specific rates which will provide the maximum contribution to the overhead burden and thus to net income. The margin above incremental costs which maximizes this contribution depends upon the price sensitivity of demand, deter-

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[5] The application of this principle in particular situations may require special care in estimating the pertinent incremental costs and incremental revenue. Especially in the short run they may be different from what they superficially appear. Example: the hidden incremental costs of dismissing and later reassembling a key work-force; and the hidden, foregone incremental revenue that may result in losing a profitable customer by refusing to take an occasional order below incremental cost.

mined primarily by the alternatives available to shippers. The judgment of management should be relied upon to make this determination, subject to limitations imposed by regulation of maximum rates and discrimination. Thus, while incremental costs should not *determine* prices or rates, they set the lower boundary (and demand conditions and regulation the upper boundary) within which pricing decisions should be made.

Railroads produce a multiplicity of different services in many markets with dissimilar demand characteristics. For example, the demand for the transportation of coal for three hundred miles eastbound may be entirely different from the demand for the transportation of the same commodity three hundred miles westbound because of competitive or market incluences. Basing rates on demand (as well as on incremental costs) to attain the maximum contribution means, therefore, that rates for all services will not be the same either absolutely, or in relation to cost, or in contributions to the net income of the carriers.

Since demands for rail services have become increasingly elastic as alternative means of transportation (both for-hire and private) have become ever more available, the greatest total contribution to net income will for many items and hauls result from a low unit margin above incremental cost and a large volume. Estimating the volume of traffic which might move at different levels of rates and the effect on net income is a key aspect of pricing. This vital function is a primary management responsibility which should be performed on the basis of managerial and not regulatory judgment. Rates so determined, however, can legitimately continue to be subject to regulation of maximum rates and to legal rules against unjust discrimination.[6]

[6]The railroads also are subject to the limitation of a reasonable over-all "return," but this regulatory limitation has not for many years of low earnings been a matter of real concern. If excessive profits were ever achieved, it would be the lawful responsibility of the regulatory authorities to apply the appropriate restraints.

Differential pricing is consistent with the public interest in the economical utilization of resources. It can yield significant benefits to the users of rail services by encouraging the retention of traffic and the development of greater traffic volumes and improved profits, thus fostering the adoption of improved technology and service, as well as lower rates.

Pricing designed to achieve such results should not be condemned as "destructive" or "unfair" competition. Rather it is necessary for constructive competition and maximal economy and efficiency in the utilization of resources. By the very nature of competition some are hurt by it. It may well be that realistic assessments of incremental costs as a pricing guide would encourage rate reductions where carrier or regulatory policies have stressed preservation of historic rate structures or keeping rates high enough to maintain "fair" market sharing. Indeed, reductions designed directly to improve profits may do so mainly by shifting traffic away from firms operating by other modes, which are thereby hurt or even destroyed. But this does not constitute predatory competition. Predatory practices must be taken to refer to temporary price reductions designed to eliminate competition in order to clear the way for high and monopolistic rates in the future. Ease and low costs of re-entry of trucks and other modes make predatory competition by the railroads unprofitable and hence unlikely. Moreover, such undesirable practices constitute a legitimate concern of the regulatory authorities. Regulatory powers should not, however, be used to prevent price reductions which are designed to improve or maintain profits by increasing or retaining traffic volume. Such prevention is particularly undesirable socially, because of the low rates of utilization of the large property investments of the railroads.

"FULLY DISTRIBUTED" COST AN INVALID BASIS FOR MINIMUM PRICING

The relevant incremental costs constitute all the cost information pertinent to the determination of floors in the pricing of particular railroad services. "Fully distributed" cost, measured by some kind of arbitrary statistical apportionment of the unallocable costs among the various units or classes of traffic, is an economically invalid criterion for setting minimum rates, from both a managerial and a regulatory standpoint. No particular category of traffic can be held economically responsible for any given share of the unallocable costs. Whether any particular rate is above or below some fully distributed cost is without real economic significance for minimum pricing.

Stated differently, the appropriate aim of the railroads is to determine that margin above incremental costs, traffic volume considered, at which a rate produces the maximum total contribution toward fixed costs and net income. Fully distributed costs cannot serve this vital economic purpose. They present an entirely false picture of traffic profitability. Their use would drive away great quantities of profitable, volume-moving traffic now handled at rates below fully distributed costs.

Another misconception is the view that if some railroad rates are below fully distributed costs a burden is imposed on other traffic which must pay more to make up the "deficiency." But, when the true significance of unallocable costs is understood, it becomes apparent that a particular rate which maximizes the contribution to such costs over and above the relevant incremental costs cannot possibly burden other traffic even though rates on the latter may be higher. If such contributions from lower-paying traffic were lost because of unattractive rates, railroad earnings and expenditures for improvements would suffer, and the ability to provide good service would be impaired. Traffic which is not moved cannot possibly help to bear the unallocable costs. It is the fully distributed cost doctrine which, by

pegging minimum rates on a false economic premise, would burden not only railroad shippers but the economy as a whole and would tend to bankrupt the railroad system by artificially restricting the economic use of railroad facilities and services.

Especially in competitive industries, no cost system can really assure that all costs will be covered and a "normal" profit earned, for sales volume will play a significant role. If guaranteed coverage of all costs and a normal profit are the objectives of fully distributed cost pricing, it cannot succeed. For that matter, neither can pricing based on relevant incremental costs plus a maximum contribution to fixed costs and net income, as determined by conditions of market demand, provide such a guarantee. But if these contributions are maximized throughout the pricing structure, the best result has been achieved and no further improvement is possible under prevailing market conditions.

Thus, the fully distributed cost doctrine does not reflect valid principles of pricing, where fixed costs are significant. Application of this false criterion in the railroads' present competitive environment would bring about prices which (for much traffic) would shrink volume. If the same total constant costs were then distributed on the shrunken traffic volume, even greater fully distributed unit costs would result, and if this should cause the railroads to raise rates still higher relative to the prices of other modes of transport, then rail traffic volume would probably be still further reduced. A costing procedure which can inaugurate such a destructive cost-price spiral is not qualified to serve as a basis for pricing in the railroad business or in any other with unallocable costs and unused capacity.

The social costs of such a pricing method could be enormous. The railroads could not function economically and quite possibly could not survive the use of this misguided basis of pricing. Under it, much traffic either would not move at all or would be moved only by modes of transportation with higher actual economic costs. The end result

would be a greater total transportation cost borne by the whole economy in return for a reduced total volume of transportation service.

"FULL COST OF LOW-COST CARRIER" ALSO A FALSE STANDARD

An offshoot of the fully distributed cost fallacy is the contention that rail rates should not be permitted to go below the "full cost of the low-cost carrier" (such carrier being determined on the basis of comparative fully distributed cost), whether it be that of railroad or a different mode of transport. This contention, also, has no validity as a measure of "inherent advantage" or relative economy in the utilization of economic resources of the nation. For the reasons pointed out above, the low-cost carrier is properly identified by incremental cost, not by so-called "full" cost.

Only a railroad's own incremental costs are of any significance as a guide in establishing its minimum rates; and this same principle applies as well to other modes of transport and other industries. Imposing a different and higher *cost* standard deprives railroads of traffic which they can transport more economically, artificially stimulates the growth of uneconomic transportation by other means including private transportation, deprives the shipping public of the benefits of low-cost service, and imposes higher commodity prices on the consuming public. However computed, the use of fully distributed costs would be wasteful of economic resources by misdirecting their use and by keeping them idle or underutilized.

In addition to its inherent defect, this specious "cost" proposal has another deficiency. To whatever extent carriers which operate on public facilities may not have to meet full economic costs in conducting their business, their "fully distributed costs" are not consistent with those computed for the railroads. For the railroads a fully distributed cost computation embraces the entire costs. The effect of the use of the "full cost of the low-cost carrier" doctrine is to obstruct the railroads in pricing their services in com-

petition with other modes to the extent that they may be subsidized. Thus, this proposal constitutes umbrella rate-making to protect any subsidized modes of transportation from legitimate competition by the railroads.

SUMMARY

1. In the determination of cost floors as a guide to the pricing of particular railroad services, or the services of any other transport mode, incremental costs of each particular service are the only relevant costs.

2. Rates for particular railroad services should be set at such amounts (subject to regulation of maximum rates and to legal rules against unjust discrimination) as will make the greatest total contribution to net income. Clearly, such maximizing rates would never fall below incremental costs.

3. Pricing which is not restricted by any minimum other than incremental cost can foster more efficient use of railroad resources and capacity and can therefore encourage lower costs and rates. This same principle applies to other modes of transportation.

4. The presence of large amounts of fixed costs and unused capacity in railroad facilities makes it especially important that railroad rates encourage a large volume of traffic.

5. Reduced rates which more than cover incremental costs and are designed by management to maximize contribution to net income do not constitute proof of predatory competition.

6. "Fully distributed" costs derived by apportioning unallocable costs have no economic significance in determining rate floors for particular railroad services. The application of such a criterion would arbitrarily force the railroads to maintain rates above the level which would yield maximum contribution to net income and would deprive them of much traffic for which they can compete economically. For similar reasons, restriction of railroad minimum rates according to the "full cost of the low-cost carrier" is economically unsound.

The undersigned economists and transportation specialists have issued the foregoing statement on the role of costs in railroad rate-making. All the signatories subscribe to it in substance, and they specifically agree with the conclusions set forth in the summary at the end of the statement.

/s/ William J. Baumol
William J. Baumol

/s/ Burton N. Behling
Burton N. Behling

/s/ James C. Bonbright
James C. Bonbright

/s/ Yale Brozen
Yale Brozen

/s/ Joel Dean
Joel Dean

/s/ Ford K. Edwards
Ford K. Edwards

/s/ Calvin B. Hoover
Calvin B. Hoover

/s/ Dudley F. Pegrum
Dudley F. Pegrum

/s/ Merrill J. Roberts
Merrill J. Roberts

/s/ Ernest W. Williams, Jr.
Ernest W. Williams, Jr.

July 10, 1962

Exhibit No: 39

STATEMENT OF JAMES M. BUCHANAN

Cost Considerations in a Regulatory Framework

Section 1. **Introductory Personal Statement.**

My name is James M. Buchanan and I hold the Paul G. McIntire Chair in Ecomomics at the University of Virginia, where I also serve as Director, Thomas Jefferson Center for Studies in Political Economy. I have been on the faculty at the University of Virginia since 1956. I have also taught at the University of Tennessee, Florida State University, and Cambridge University in England. On various occasions in past years, I have served as an economic consultant with the Committee for Economic Development, the RAND Corporation, the Treasury Department, the Council of Economic Advisers, and numerous other agencies, both public and private. I have written six books in the field of economics, including two basic textbooks, and I have published some fifty professional papers. Included in this material have been technical papers on the relation of incremental costs and prices, both in terms of general economic theory, and in particular reference to railroad service and highway service pricing. I am immediate past president of the Southern Economic Association.

This statement will discuss general economic principles as these pertain directly to rate making in transportation. It is not intended to and it does not attempt to discuss the historical and institutional details of rate regulation. The statement is an application of economic analysis.

Section 2. **Incremental Cost Considerations.**

The Interstate Commerce Commission is responsible for the preservation and promotion of the inherent advantages of the various transportation media within the framework

of an integrated and coordinated national transportation policy. This objective may be translated into economic terminology by saying that the Commission's responsibility is the prevention of the abuses that might arise to inhibit the development of an efficient transportation system.

Pertinent questions arise concerning the definition of an "efficient" system. Presumably, efficiency should be interpreted here in a manner similar to that generally employed in analyzing the performance of the national economy.

It has long been an established tenet of national policy that unregulated competition is not allowed to exert controlling influences over the transportation economy, to the extent that prevails in other sectors. For purposes of declared national interest, public regulation has been introduced and maintained to replace, to a partial extent, free and open competition as the instrument that will insure economic efficiency.

The principle for promoting economic efficiency through regulation is that of producing results that are similar to those that would emerge from a competitive structure. Essentially, therefore, the aim of regulation should be that of allowing the transportation sector to respond as fully as possible to the forces of the market economy, while preventing abuses that are known to generate serious inefficiency. In carrying out this aim, the developments in the transportation industry that have increased effective and potentially effective competition should not be overlooked. To the extent that potentially effective competition emerges, the positive need for direct regulatory action in control of abuses may be reduced.

The following questions become germane: (1) What are the relations between prices and costs in an effectively working market? (2) What conception of cost is used to guide decision-making in the competitive sector?

Perhaps the most widely accepted principle in formal economic theory states that, for purposes of making rational decisions, sunk costs should not be considered and that mar-

ginal or incremental costs, appropriately measured, are the only relevant costs. In a competitive industry, business firms must make decisions on the basis of incremental costs if they are to survive; any attempt to make pricing and output decisions on the basis of full costs or fully-distributed costs would insure eventual bankruptcy.

The testimony submitted by Professor William J. Baumol has emphasized the necessity of utilizing incremental cost considerations in the regulatory process which grants approval of rail freight rates. The theorems applied by Professor Baumol to this particular problem are strictly within the corpus of accepted economic theory, and I know of no professional economist who would dispute these theorems.

The question that remains is: Are there features peculiar to rail transport, or to transportation in general, which suggest a departure from orthodox economic principles? Three possible arguments for applying something other than incremental costs as the basis for decision-making will be examined.

1. It might be argued that some departure from the strict application of incremental costing principles, narrowly conceived may be justified to the extent that the incremental costs, as these are calculated by the carrier, do not accurately or properly reflect the genuine incremental costs *to the whole community.* In other words, it could be argued incremental cost considerations should be more inclusive than those borne by the carrier in question. In particular application to rail freight rates, this argument seems clearly to be irrelevant. For competing media, such as trucking firms, where no explicit charges are made for congestion that is created by their activities over publicly-owned rights-of-way, the incremental costs borne by the carrier may fail to reflect fully the "social costs" incrementally imposed on the whole community. Similar conclusions follow with respect to barge-line operations where firms are not required to pay user charges for publicly-supplied facilities. In any comparative sense, the incremental costs borne by railroad

companies approximate genuine "social costs" more closely than those which apply to competing media.

2. A second argument for departing from orthodox economic precepts might be advanced if it could be shown that the use of incremental costs as the basis for setting rate floors serves to produce "unjust discrimination," something which is explicitly prohibited in the statement of National Transportation Policy.

But what is "unjust discrimination"? The economist cannot, of course, determine what is or what is not "just" or "unjust" in an ethical sense. Economic theory can, however, make appropriate distinctions between those changes in rate structures that lead to greater efficiency and those that lead to less efficiency. In these terms, arbitrary *increases* in rates to particular groups of users, i.e., increases that serve to *reduce* the flow of traffic on segments of the system create inefficiency. By contrast, the introduction of additional flexibility in rate structures by allowing some rates to move toward levels indicated by incremental cost floors serves to bring additional traffic into being, while increasing rates to no users of the service. Again, it is a familiar principle of economic theory which states that, to the extent that additional traffic is generated as a result of rate reductions of this nature, the output of the supplying industry moves closer to national "optimum" or "efficient" level. The allocation of the nation's resources will be improved, rather than worsened, in accordance with the standard criteria, by the introduction of such "market-extending" flexibility in rate structures, based on incremental cost floors. It seems evident that this sort of flexibility in a rate structure does not constitute "unjust discrimination," if any meaningful economic content is to be given to this term. Therefore, the prohibition of "unjust discrimination" does not involve any departure from the use of the incremental cost standard in making decisions on the rate structure.

3. A third possible argument against the application of orthodox economic precepts concerns the possibility that

the full implementation of incremental costing as the basis for rate floors might introduce "unfair or destructive competitive practices." This argument introduces directly the relation of the rate structure of rail carriers to the position of competing carriers.

As Professor Baumol has pointed out in this testimony, the incremental costs confronting the railroads also approximate very closely the incremental costs for this sort of transportation activity to society as a whole. If, therefore, additional traffic can be shifted to this medium by lowered rates within the limits imposed by incremental cost floors, there is a total gain to society, even should all of the additional traffic be drawn from the custom of competing media. The failure to allow such traffic-generating rate reductions amounts to making society pay more than is necessary for the transportation services that it requires. And the unnecessary extra payment represents socially unjustified monopoly gain, even if firms in the transportation industry do not make monopoly profits. In this case, the gain is absorbed by the maintenance of inefficient traffic patterns, patterns that would be eliminated by the introduction of additional rate flexibility.

In so far as the incremental cost basis for setting rate floors is accepted for one medium, it should, of course, be accepted also for all other media. And if, in fact, a threatened diversion of traffic to railroads is not "efficient" in the overall sense, this will be demonstrated by the evidence that incremental costs on competing media will be lower, not higher, than those on the railroads. There is nothing unique about the applicability of incremental cost floors to railroad transport. The principle is a universal one, applicable to any industry, whether regulated or unregulated.

On the criteria of national economic efficiency, if an industry supplying a service cannot survive and remain profitable in the presence of incremental cost floors imposed on its pricing structure, it should not be supported by regulatory agencies charged with maintaining the inherent ad-

vantages of the various media. In such a case, there is simply no inherent advantage to the inefficient media, and efficiency considerations dictate their abandonment. To argue otherwise is to equate the inherent advantage norm with the promotion of resource waste in transportation.

This point can easily be illustrated with simple examples. The diesel locomotive has replaced the steam locomotive, almost completely, because it is the more efficient engine. The steam locomotive simply possesses no inherent advantage in a modern railroad system. Essentially the same logic must be applied to any consideration of the integrated transportation network, or even to the whole economy. Some media may, at any particular period of time, become inefficient as a result of technological progress and economic change. The covered wagon as a mover of freight was replaced completely. It is impossible to judge which medium possesses "inherent advantages" except in so far as the results of properly applied and implemented pricing policies are allowed to emerge in the normal order of events.

It is impossible to determine "inherent advantage" in advance of results through some application of arbitrary formulas. Attempts to prejudge such advantages on some non-economic basis, and to make regulatory decisions thereupon, tend to prevent the emergence of the very results which are, in fact, required for economic efficiency. Thus, the irony is that the use of false norms may prevent the attainment of the objectives that the whole regulatory structure is designed to achieve.

This is not to deny, altogether, that "predatory competitive practices" can exist, and do exist in some instances, although these are less common than is often thought to be the case. As Professor Baumol has correctly indicated, genuinely predatory practice (which must involve pricing below incremental costs with the aim of driving out competitors), must, in the nature of the case, inflict losses on the predatory firm. Such a practice is, moreover, largely unprofitable to the firm that attempts it, even over the long run, until

and unless this firm, also, can effectively prevent competing firms from re-entering the industry from which predatory competition drives them initially. This would imply, in the case of railroad rates, that successful predatory policy requires rather complete monopoly controls over entry into all competing transport media. Surely, the presence of the overall regulatory framework insures that railroad management would have little, if anything at all, to gain from predatory practices in the modern transportation system. Even if a railroad should, successfully, drive out competitive firms in a particular area of service by accepting unprofitable business for some short period, this railroad could not expect readily to recoup these short-term losses because it could not, in any way, control or prevent the re-entry of new competitive firms when rates were again increased, even should such increases be allowed by regulatory authorities. Given the ease of entry into both barge and road transport, the attempts to exploit monopoly gains to offset initially-incurred losses from predatory practices would quickly re-attract resources into competing media. In sum, the possibility of predatory price-cutting as a profitable undertaking for the modern railroad seems remote indeed. And, to the extent that this possibility may arise in the isolated instance, the prevention of rates from falling below incremental cost levels would be sufficient to forestall all dangers of such predatory behavior, whether rationally or irrationally motivated.

It is clear that none of the three arguments examined justifies any departure from the application of orthodox economic principles which require that regulatory decisions on railroad freight charges be based on incremental cost considerations.

Section 3. Incremental Costs and Full Costs.

In the preceding section, I have demonstrated that there is no justification for a departure from orthodox economic criteria in establishing the regulatory framework for railroad rate making. In this section, I shall discuss the opposing

principles calling for rates based on "fully distributed costs" and on incremental cost floors. I shall show that the appropriate decision-making context is vital to the understanding of these principles. Confusion has arisen out of what is essentially a backward-looking, or auditing, conception of economic reality. Decisions, whether these are made by individuals, firms, or regulatory agencies, are necessarily forward looking, and it is always erroneous to base such decisions on past events that are irrevocable.

In a forward-looking context, all costs are incremental. The only costs that are relevant for rational decisions are those costs that *will be incurred as a result of taking the decision.* Costs that must be borne as a result of past commitments are not really economic costs at all. To attempt to call these costs, and to add these to the incremental costs that are predicted to occur in carrying out a decision, amounts to a distortion of the choice-making process by making the *costs of the decision* appear higher than is actually the case.

This is straightforward economic theory, but it is often overlooked, even by sophisticated theorists. The confusion here stems, at least in part, from the fact that, in ordinary conditions of business behavior, no conflict between incremental cost pricing and the recovery of full costs seems to arise. In the long run, the total revenues of business firms in competitive markets must cover the costs of their entire operations if they are to survive, and such firms are continually in the processes of making decisions of many kinds. In each decision, rational behavior involves a balancing off of incremental costs, *to be incurred after decision,* against incremental benefits, *to be enjoyed after decision.*

What results will behavior of this sort produce over the long term? Historically speaking, if each and every decision is informed by an accurate prediction of incremental costs and benefits, and if no decision is ever taken unless the benefits are expected to be in excess of costs, then it necessarily follows that, in total, revenues produced will be suffi-

cient to cover the total costs of the operation. Thus, in an idealized world in which firms all possess perfect information as to the future results of each decision made, including long-term investment decisions, incremental cost decisions would appear to produce results that would also be consistent with full cost decisions. But business firms do not make decisions in an idealized world where the future can be predicted with certainty; decisions must, in each case, be based on the best information that is then available to the firm, and errors in prediction must occur in a changing world. When error is allowed for, the results of incremental cost decisions may diverge sharply from those based on the use of fully distributed costs.

Hence, the basic confusion here stems from the proclivity to observe results that must emerge from the long-run adjustment process in the competitive economy, when all errors have been "ironed out," so to speak, and to infer that these results can be implemented directly, without the adjustment process taking place. Thus, it is inferred that pricing decisions based on fully-distributed costs provide the proper benchmark for regulatory activity, an inference that overlooks the adjustment process that must produce such a result. The making of decisions on the basis of an appropriate comparison of incremental costs and incremental benefits is, over the long term and allowing for full adjustment, perfectly compatible with the production of revenues sufficient to cover the total costs of the operation. By contrast, if an attempt is made to set prices, explicitly, so as to cover "full costs," in some backward-looking sense, this will, necessarily, tend to forestall the very adjustment process that is required to insure overall economic efficiency.

A simple analogue from economic theory may illustrate this point. We know that the rate of return on capital investment tends to be equalized in all investments. From this, however, we cannot infer that an imposed equalization of rates of return in various employments would produce desirable results. Obviously, the way in which rates of re-

turn tend to become equalized is through the flow of capital resources among the various industries, *in response to different rates.* Equalization among rates of return is a result of this process, not a norm.

There are features peculiar to railroad ratemaking, and its regulation, that make the distinction between incremental cost decisions and fully-distributed costs decisions especially important at the present time. The railroad structure that exists is the result of many past decisions, past commitments. It is an old industry, and it is known to embody a heavy capitalization in fixed plant, of a longlived variety. This essentially technological fact, plus the changing patterns of demand for transportation services, insures that fully-distributed costs for the railroads are necessarily high if these are measured in a backward-looking sense. But, as I have tried to show, the costs or outlays that must, in any case, be incurred as a result of *past* decisions are, or should be, wholly irrelevant for the making of forward-looking decisions, which are, of course, the only decision that can be made, *in the present.* The costs that are relevant to present decisions are those that must be incurred, incrementally, as a *result of taking a decision,* whether this be a decision on investment, on the inauguration of a new service, on a modification in a rate structure, or a decision of the Commission to allow some variance in existing rates.

All of this can, perhaps, be clarified by a homely example. Suppose that Jones has purchased a $6 ticket for next Saturday's football game, which entitles him to a seat on the 50-yard line. Suppose, also, that Brown has purchased a 50-cent ticket that entitles him to stand in the end zone. Saturday now arrives, and it is pouring rain. What considerations should Jones and Brown take into account in deciding whether or not to go to the game? Surely each man should try to balance off his changes of getting pneumonia (his incremental costs) against the benefits that he expects to enjoy from watching the rain-soaked game. Once they have got their tickets earlier in the week, the money outlay,

the money costs, paid for these tickets are irrevocably "sunk," and these should have no place in their decisions as to whether or not to go to the game. The mere fact that Jones has paid more for his ticket, as a result of a past decision, than has Brown should not suggest that Jones should, because of this higher "full cost," brave a greater chance of getting pneumonia.

In rate making, railroads seem often to be placed in the position of Jones in this example. Because they have, in the past, made decisions embodying a large total outlay than has been covered in receipts, it is argued that railroads should, in their forward-looking current decisions, set rates for predicted future operations so as to reflect these past commitments. This argument is no more sensible for the railroads than for Jones. To prevent the railroads from lowering rates to incremental cost levels because fully-distributed historic costs are not covered is analytically equivalent to forcing Jones to stand in the rain because he has previously bought a high-priced ticket. And Jones who stands in the rain when he should be at home by his fireplace, is analytically in the same position as the railroad company which, because it is forced to charge unduly high rates, watches traffic carried by other media which it could, effectively and profitably, move with its own equipment.

Section 4. **Cost Comparisons Among Competing Carriers.**

It is a commonly accepted principle of economic theory that prices will tend to be equalized among firms supplying essentially the same services. This result *emerges* out of the workings of the competitive process, however, and it does not imply that a directed or forced equalization of prices, before the adjustment process of competition has been allowed to work itself out, will be beneficial. This point is very similar to that which was made above with respect to full-cost pricing. In fact, a forced equalization of prices will prevent the very adjustment of custom among competing suppliers of services that is necessary to produce efficient transportation.

The argument to the effect that rail freight rates should be based somehow on the "costs of the low cost carrier" amounts to an application of essentially this sort of backward reasoning to the problems of rate making. If, in fact, regulation is efficient in allowing for the *emergence* of that pattern of traffic among competing media which incrementally oriented decision making would produce, incremental costs for the low-cost carrier will tend to be rate-determining, for all media. However, it is essentially reverse or perverted logic to argue that, because this result tends to emerge, steps should be taken to implement this result *directly* by setting rates on the lowest-cost carrier basis. To attempt this would surely prevent the very shifts in traffic flows which would, over time, guarantee the equivalence of incremental costs, among genuinely competing media. In point of fact, the only way in which competing media can be observed to be supplying similar services lies in the results that are allowed to emerge from the traffic adjustments to rates that are allowed to emerge from the traffic adjustments to rates that are related to incremental cost floors, appropriately measured. It is impossible for the external observer, be he specialist or layman, to determine what are *similar* transportation services, independently of the demand-adjustment process in response to varying rates. For such an observer to attempt to determine what are "similar" services, and to use such an impressionistic classification as a basis for rate differentials, requires an omniscience that few mortals possess. This is because "similarity" or "equivalence" in services, in economic terms, can only be defined rigorously with respect to the degree which ultimate users, consumers or buyers, are willing to *substitute* the services of one supplier for another. Any test of similarity requires, necessarily, observation of the degree to which buyers are willing to make such substitutions. And rate making on the basis of presumed similarity in service, grounded, perhaps, on a superficial resemblance, will tend to prevent the very adjustments that would allow user substitution to take place.

Section 5. **Summary and Conclusion**

By way of summary, there appears to be no basis in theoretical economic analysis for the imposition of floors on railroad freight rates that are above incremental costs, appropriately defined with respect to the operation of the railroad under consideration and over the time span that is relevant. If the objective of national transportation policy, and of rate regulation, is that of promoting overall efficiency in the economy, the primary efforts of regulatory agencies should be aimed at preventing unjust *increases* in rates by carriers, made possible by localized monopoly situations, and not in preventing decreases in rates, especially when such decreases do not bring rates below appropriate incremental cost levels. If localized monopoly positions exist, and the efforts of the regulatory agencies were directed toward these, the stated objectives of the national transportation policy would be served. The regulatory authorities should, in the course of carrying out this task, keep a watchful eye for genuinely predatory practices where and when they occur. But allegations of "predatory practice," "unfair competition" or "unjust discrimination" should not be allowed to become a cloak behind which the inefficient operations of various transportation firms are protected from the test of genuine, even if regulated, competition.

Exhibit No. 40

STATEMENT OF RICHARD B. HEFLEBOWER

My name is Richard B. Heflebower. Since 1949 I have been professor of economics at Northwestern University. Prior to the War, I held that rank at Washington State University and also was Dean of the School of Business Administration. From February 1943 to August 1946, I was with the Office of Price Administration and for most of that

period was an economic advisor to the Deputy Administrator for Price. From 1946 until joining the Northwestern University faculty, I was a member of the senior staff of the Brookings Institution in Washington, D.C. In the research that I carried on there and since, and in teaching graduate students, I have specialized on the problems of the structures and behavior of markets, especially price behavior. My publications have dealt chiefly with competition and prices. At various times I have been an economic consultant to industrial corporations and to government agencies and to the non-profit Committee for Economic Development.

With respect to the problem being examined in this hearing, economists have held quite uniformly to the same findings for decades. I refer to the well-worked out criteria of the optimal use of an economy's resources and of the corresponding economically-best prices of commodities and services. The relevant definitive parts of economic theory, or principles, have been clearly set forth in Professor Baumol's testimony. Several implications of these economic principles have been developed by Professor Buchanan. He has also shown how these principles contribute to optimal use of resources devoted to transportation and to the welfare of shippers and consumers.

I shall relate these principles specifically to certain features of the railroad industry, particularly those that explain why the optimal use—the socially most efficient use—of resources devoted to transportation does not require that each rate bear the same relation to the relevant costs. These costs, as economists agree, are the incremental costs.

1. The Relevant Time Period.

Economists' analysis of the relations among the relevant costs and demand on the one hand and prices or rates on the other hand involves the same general principles, no matter what the pertinent period of analysis. But the choice of cost (and sometimes of demand) to be included in the calculation does depend on the length of period or "run" involved in the problem.

The "length of run," that is, the length of time relevant for pricing decisions, is not given by any fixed span of calendar time—a certain number of months, years, or decades. Rather, the pertinent length of time depends on how long a waiting period is required before current commitments are terminated so that new decisions can be made about them. For example, decisions relating to a piece of equipment whose expected economic life is 20 years, involve a 20-year commitment (except insofar as part of its cost can be recovered by sale) and that is the relevant time period.

In accord with economic analysis, we may distinguish three such types of period, the short-run, the intermediate long-run and the long-run. The first of these, the "short-run" refers to a period shorter than the life of depreciable physical facilities and equipment. Except for extraordinary pricing decisions—for example those concerned with prices applicable only for a short period of time—the short-run is too brief for the relevant cost calculations. Ordinarily, prices which cover only such short-run incremental costs will not make the necessary contribution to the maintenance and replacement of depreciable equipment. Similarly, the very long-run is not the relevant period because in railroading many facilities are essentially permanent—they require maintenance but not replacement. Rather, it is the intermediate long-run costs which are pertinent since prices which cover intermediate long-run incremental costs provide the funds for replacement of all facilities which are not permanent and for which a continuing demand is anticipated. This "intermediate long-run" corresponds to what is meant by "long-run" in the last line of the main text of page 2 of "Explanation of Rail Cost Finding Procedures and Principles Relating to the Use of Costs."

2. **Excess Capacity in Railroading.**

There are several unusual characteristics of railroad cost structures which are important for their pricing decisions. As already indicated, a substantial proportion of the railroads' facilities are, for all practical purposes, permanent.

Moreover, these facilities are typically characterized by substantial excess capacity, an important fact related to rate policy as will presently be shown. Such excess capacity in these quite permanent basic facilities is usually a built-in inherent feature of railroading.

For a railroad to exist at all, it must have a large minimum capacity in line-haul way and structures and in some terminal facilities. Consequently, the economies of scale (potential effect of size of plant on cost per unit of service) are marked in railroad transport. It is true that its basic facility (line haul and terminal facilities) can vary widely in its qualities and, hence, in its capacities. But large scale basic facilities will often result in lower costs, even when used below capacity, than will low capacity facilities, particularly if weight is given to the lower quality of service which results from the use of the latter.

Usually, in order to give the quality of service that is optimal for shippers as a group, the quality of roadbed and bridges, and the weight of rails must be (and quite generally is) such as to permit fairly heavy trains to move at more than creeping speeds and to operate with minimal interruptions of service. Either because of such necessity or of an earlier optimistic forecast of traffic volume, railroads quite generally have excess capacity in line haul basic facilities. Excess capacity means that more trains could be operated over the tracks and the road's total cost (including capital and other costs related to permanent facilities) per train mile or per ton mile would decline without causing a significant decline in quality of service in terms of effect on shippers' (as a group) own operating costs.

An additional source of excess capacity of basic facilities is the "way and structures" quality and capacity required to provide these transport services in which railroads have a relative advantage. Heavy loads of bulk commodities are often of this sort. A well-built roadbed and heavy rails may minimize costs of such hauls even though once built they represent excess capacity.

Given this "built-in" excess capacity—primarily in the railroads' permanent facilities—additional traffic that provides incremental revenue above intermediate long-run incremental costs has two effects. It provides added operating revenue in excess of additional or incremental costs and, in a term frequently used, thereby makes "a contribution to burden." Second, the increased traffic enlarges social output from these fixed facilities; overall efficiency of resource use in transportation is enhanced thereby.

3. **Differences Between Rates and Incremental Costs.**

Where excess capacity such as that just portrayed is present—and, in fact, it prevails quite generally throughout the railroad industry—rates that beat variable relations to long-run incremental costs are economically preferable to rates for different transport services, each of which equals some estimate of total costs, including costs that are not variable in the intermediate long-run.

If railroads use intermediate long-run incremental costs as a rate floor, by inference many rates will be above the floor, and indeed, above fully-distributed—or some other measure—of total cost. But it can also be inferred that the rational guide to such higher rates (relative to long-run incremental costs) is the intensity of demand for the service in question and, more specifically, what economists call the elasticity of demand. It should be emphasized that what is relevant is not the elasticity of demand for transportation but for *transportation of the particular segment of the traffic in question by rail.* Consequently, the rational determination of the level of such a rate must rest on consideration of incremental cost *and of incremental revenue,* i.e., the effect of varying levels of the rates on the aggregate revenue derived by railroads from hauling that commodity.

It may be contended that such variations in railroad rates relative to their corresponding incremental cost floor constitute unfair treatment of these shippers who are charged higher relative rates. Such an inference is incorrect; the fact that the railroad can charge the higher rate and nevertheless

obtain the traffic must reflect either the superiority of the railroads' services or the unavailability of another form of transport with intermediate long-run incremental costs below these rail rates. Furthermore, to the extent that the railroads' incremental revenue from traffic obtained at lower rates (that are above the floor, of course) exceeds incremental cost, the effect is to lower the level of full costs per ton mile. ("Permanently" fixed costs are spread over a larger volume.) An incremental cost floor rate policy thereby permits the very rates that are alleged to be "unfair," in fact to be lower than they could be otherwise.

What has been shown here is that an intermediate long-run incremental cost floor with rates for various transport services varying upward from that floor, is necessary for the optimal use of resources in the railroad industry. It has been demonstrated also that rates for different services that bear different relationships to such an incremental cost floor do not treat some shippers unfairly. These conclusions are reached by use of established economic principles applied in a manner appropriate to the unique features of the railroad industry.

4. Relation to Other Transport Modes.

What remains is the consideration of the effect of such a rate policy on other transport industries and through that on a social policy for optimal use of resources in transportation.

Where the intermediate long-run incremental cost of another transport industry is above that of railroads (for service of equivalent quality) that other industry is not as economically efficient as the railroads. On the other hand, where the intermediate long-run incremental cost of any other transport mode is below that of railroads, it is more efficient.

Application of this principle requires some care. The costs of other transport industries that clearly measure their relative economic efficiency are their own long-run incremental

costs plus the *social* incremental costs of the publicly-owned facilities—including, for example, highways, waterways and airports—which they use in providing the service being priced. When proper account is taken of such social incremental costs, and it is established that the railroads' intermediate long-run incremental costs are lower than those of other carriers, the railroads are the more socially efficient transport mode, and vice versa. Protecting a carrier that is less efficient by this criterion against lower rates of the more efficient carrier creates a barrier against the efficient use of society's resources.

5. **Summary Comments: Inherent Advantage.**

Now the criterion for measuring the "inherent advantage" of a type of carrier becomes evident and provides the central theme for summarizing economists' interpretations of that term. Where cost is the only pertinent factor, a synonym for "inherent advantage" or "inherent disadvantage" of a type of carrier is the level of its intermediate long-run incremental costs compared to the incremental costs of other types of carriers. Rates of one type of carrier that are not below its intermediate long-run incremental costs cannot, therefore, injure another type of carrier which has a superior inherent advantage or, in the economists' language, a type of carrier that uses resources more efficiently. Only a type of carrier less efficient in use of resources can be injured by a rival's rates below the former's intermediate long-run incremental costs; and it is injured only because it is not socially efficient.

By no means does this test of social efficiency require that all types of carriers establish the same rates for a particular haul. There are differences in the quality of service various carriers are capable of rendering or do render. On the other hand, speed of delivery and other aspects of service are of differing value to various shippers. So long as no type of carrier charges less than the appropriate incremental cost, choice of carrier according to relative rates and related services should be left to the shippers, as Professor Buchanan points out.

Nor do rates have to be as low as the intermediate long-run costs, or have a uniform relation to those costs, in order to meet the criterion of optimal social usage of resources in transport. All problems of price determination involve demand as well as the relevant costs. Rates for different services necessarily reflect the elasticity of demand for the various services, or the extent to which higher or lower rates would affect the volume of a particular carrier. Consequently, a carrier can be expected to have some rates near incremental costs and others higher, even above some measure of total costs such as fully-distributed costs. Shippers paying the higher rates are those for whom there is not an alternative type of carrier able (because its incremental costs are lower) or willing to perform the service at a lower rate.

Rates that bear differing relations to incremental costs are particularly important for railroads because of the diverse conditions under which these carriers operate. They are the most general type of carrier for they serve nearly all parts of the country and haul almost every commodity in a wide variety of sizes of shipments and length of haul. The scope of the service offered by competing carriers of different modes is narrower in terms of their routes; the type of commodities carried; the length of their hauls; and, sometimes in the season of the year during which they operate. They select the combination of traffic characteristics for which their type of facilities and equipment is peculiarly adapted. But the test of their general efficiency in rendering this service is their intermediate long-run incremental cost. Only where these costs are below the intermediate long-run incremental costs of the railroads are they the more efficient carriers. A railroad rate floor which is based on intermediate long-run incremental cost will, therefore, provide ample protection for the inherent advantages of competing modes of transport.

Exhibit No. 38

I.C.C. Docket 8038
Witness: Ford K. Edwards
Exhibit _____

BEFORE THE
INTERSTATE COMMERCE COMMISSION
WASHINGTON, D.C.

INGOT MOLDS -
PENNSYLVANIA TO STEELTON, KENTUCKY
I.C.C. Docket 8038

Testimony of Ford K. Edwards

April 21, 1964

Exhibit No. 38

Q. 1. Will you please state your name and address.

A. Ford K. Edwards of Edwards & Peabody, Transportation Consultants, 1111 E Street, Washington 4, D.C.

Q. 2. Will you please state your education and experience.

A. I have a degree of Bachelor of Science in Electrical Engineering from Iowa State University (1925). I also have a Master of Arts degree in Economics with a Transportation major from Yale University (1927). I received my Ph.D in Economics from Yale University in 1933.

My experience embraces eight years in the operating and traffic departments of railroads, motor carriers and telephone utilities; four years as transpor-

tation economist and examiner with the California Public Utilities Commission; ten years as principal economist, head cost analyst and Director of the Bureau of Accounts and Cost Finding of the Interstate Commerce Commission; six years as Director, Department of Coal Economics, National Coal Association; and five years on the staff of the University of Southern California, College of Commerce and Business Administration, conducting courses in the general fields of economics and finance, as well as in the areas of rail and motor transportation, public utility regulation and traffic management. Since May 1, 1956, I have maintained offices as Transportation Consultant in Washington, D.C.

Q. 3. Have you done any writing in the area of transportation costs, rates and economic principles?

A. Yes. The studies and reports I have written or directed include Principles of Motor Transportation - McGraw Hill Company; A Study of Rail Cost Finding For Rate Making Purposes, California Public Utilities Commission, 1938; A Study of Rail Freight Service Costs in the Various Territories of the United States; U.S. Senate Document 63, 78th Congress, 1st Session; and an Interstate Commerce Commission study entitled "Explanation of Rail Cost Finding Procedures and Principles Relating to the Use of Costs"(1954).

Q. 4. Have you made an analysis of the levels and structure of railroad freight rates in the United States as they relate to the costs of performing the service?

A. Yes. I refer to the so-called burden studies of the Interstate Commerce Commission showing the levels of freight revenues by commodities and territories and their relationship to the out-of-pocket costs.

Q. 5. What do you consider to be the pertinent costs in this proceeding for rate-making purposes?

A. As is generally recognized, price determinations throughout the economy basically rest on the factors of supply and demand. The regulated industries are no exception. Pricing must reflect the economic incentives necessary to induce those who supply the goods and services to make the necessary financial commitments. Where a multitude of services are produced by a plant, many costs cannot be individually traced. These non-traceable costs include both fixed expenses which do not change in magnitude when the quantity of output varies, and joint costs which exist when the production of certain goods or services makes available directly related products or services. Rail back-hauls are illustrative.

As a result of these characteristics, long recognized by transportation economists and those engaged in transportation pricing, there is no fixed relationship between rail transportation costs and railroad rates. In my judgment, rail cost ascertainments serve but one primary function in pricing, i.e., to determine the out-of-pocket (incremental) costs of carriage. The expenses so determined set the floor below which particular rates and charges should not go. Total system expenses for all rail services performed, freight and passenger, including a return on capital employed, indicate total system revenue requirements.

As I have said, the levels of the individual rates assessed for the many services rendered by a railroad to its shippers are governed by the market factors of supply and demand to the same extent that market elements control pricing generally throughout the economy. Faced with these economic realities, the necessary aim of the railroads is to determine that margin above out-of-pocket costs at which a rate produces the maximum total contribution to fixed costs and net income, the volume of the traffic induced being a necessary consideration. Under

such approach, each shipment contributes in accordance with its ability to pay, or market capabilities. The volume of traffic and aggregate dollar contribution of the lower rated commodities to fixed costs are thereby maximized. At the same time the burden on the higher rated commodities with comparatively inelastic demand is less than that which would apply under any other system of pricing.

A most critical factor in pricing is that the "cost floor" be that which correctly reflects the out-of-pocket or added costs undertaken by the carrier in handling the shipment being priced. If rates are set too high, they may act to discourage traffic which, in fact, is profitable. Both as to concept and practical application this out-of-pocket cost "floor" should reflect, to the fullest extent possible, the actual additional costs undertaken in the handling of the traffic in issue. Such costs are commonly referred to by economists as the incremental or marginal costs.

Transportation economists and regulatory authorities, notably the Interstate Commerce Commission, have long recognized the "value-of-service" rate-making principles which are here involved. The Interstate Commerce Commission's annual studies on the "Distribution of the Rail Revenue Contribution by Commodity Groups" clearly demonstrates the universal application of such principles to rail rate-making under conditions of constant costs. This document, issued each year, identifies the tonnage, revenues, out-of-pocket costs and revenue contribution to burden of each commodity transported by the railroads. At Table 7 the profitability of each class of traffic for 1960 is measured by the dollars of contribution (above out-of-pocket costs) toward the constant costs and other overhead expense burdens. The Commission's statement for 1960 shows the

tonnage handled at rates which yielded less than the so-called fully distributed costs. Such tonnage amounted to 789 million tons out of the total rail carload tonnage handled in 1960 of 1,203 million tons. In short, 65 percent of the rail tonnage in 1960 moved at rates below the so-called fully distributed cost levels. The lack of any economic significance to fully distributed costs as a guide to rate determination is here clear.

For the reasons given above, the rail "out-of-pocket" or incremental costs have a critical significance in determining that level of the rate which will yield the maximum contribution to fixed costs and burden. Thus, if rates were set merely at the "out-of-pocket" cost level the revenues would but equal the added costs incurred to handle the traffic and no contribution to fixed costs or buden would be made. As the contribution per ton is the difference between the out-of-pocket costs per ton incurred in taking on the traffic and the revenue per ton received, the aggregate contribution of the traffic to constant costs and burden is maximized at that combination of rates and volume where the product of the number of the tons carried and the margin of the revenue per ton over "out-of-pocket" cost is the greatest.

These incremental costs, i.e., the added expenses or so-called out-of-pocket costs which are incurred as a result of the handling of the involved traffic constitute, in my opinion, the only costs of service data which are pertinent or significant to the economic determination of a rate.

Q. 6. To sum up, in your judgment what is the critical part played by cost of service determinations in fixing rates?

A. In my judgment the *sole* purpose of cost finding in fixing rates is to ascertain the cost floor or break-even point in handling the added business.

Q. 7. Would the rates or rate structures be set at this break-even point?

A. No, they would not. Rates will be set at various margins above this level depending upon the ability of the traffic to pay, i.e., on value-of-service considerations. Both in principle and practice the foregoing means the fixing of rates at such margins over incremental or out-of-pocket costs as will maximize the contributions to constant costs and other revenue requirements.

Q. 8. Is the incremental cost here a direct determinant of the rate itself?

A. No, it is only a part of the rate build-up. If the rate were constructed at the level of incremental costs, there obviously would be no contribution to the constant costs.

Q. 9. Is it important that the incremental costs accurately reflect, insofar as possible, the additional expenses which the traffic under study occasions?

A. I believe it to be important that the expenses reflect, insofar as reasonably attainable, the added costs of handling the involved traffic. If the costs here employed are erroneously high, or if they include constant costs or passenger deficits, they will have the effect of discouraging traffic which can be profitably transported.

Q. 10. Does the historic pattern of rail rates and charges conform to the rate-making basis you have here described?

A. Yes. Shortly after the Commission's freight traffic Waybill Studies were inaugurated the Cost Section of the Commission introduced its studies of the "Distribution of the Rail Revenue Contribution by Commodity Groups." The purpose of these studies was to indicate the compensativeness of the rail rates by commodities and territorial movements.

Q. 11. Do these Commission releases indicate the profitability or revenue contribution of each class of commodity carried?

A. Yes, the annual studies of the Commission make such a showing. These studies report not only the percentage relationships between the revenues and the out-of-pocket or incremental costs, but also the critically significant figure of total dollar contribution earned over and above the incremental costs.

Q. 12. Have you prepared a table showing relationships of revenues to out-of-pocket costs which illustrate the principles you speak of?

A. Yes, shown in the table to follow are the ratios of the revenues to the out-of-pocket costs for certain commodities and commodity groups. The out-of-pocket costs here referred to include, among other factors, an allowance for return on 100 percent of the equipment and 50 percent of the road property.

TABLE I

Revenue Contribution by Selected Commodity Classes and All Commodity Groups, 1960

U.S. to U.S.

Commodity and Code (1)		Ratio Revenue to Out-of-Pocket Costs (2)	Contribution Above Out-of-Pocket Costs (Millions) (3)
	Individual Commodities		
305	Bituminous Coal	110	88
309	Iron Ore	114	26
411	Lumber, Shingles, Lath	136	82
549	Plastics	190	12
553	Drugs, Toilet Prep.	155	2
597	Machinery Parts	249	12
685	Electrical Equipment	217	20
	Commodity Groups		
900	Products of Agriculture	119	167
910	Animals and Products	107	14
920	Products of Mines	109	152
930	Products of Forests	118	84
940	Mfrs. & Misc.	152	1,226
960	All Commodities	129	1,658

Source: I.C.C. Statement No. 2-62, May, 1962.

The illustration in Table 1 above demonstrates the fact that the margin of revenues above out-of-pocket cost is not the significant rate-making factor. Rather, the significant factor is the volume response of the traffic to the rates set and the resulting aggregate dollar contribution to burden.

Whereas the revenues on some commodities cover their out-of-pocket costs by very small margins, the volume of the movement indicue is of such magnitude as to make such traffic among the most profitable handled by the railroads.

Referring to Table 1 above, bituminous coal, Commodity Code 305, moves at rates averaging but 10 percent above out-of-pocket costs yet yields a contribution of $88 million, an amount exceeded by but very few commodities.

It is to be noted here that the relatively highrated Commodity 597, Machinery Parts, moves at rates 149 percent above out-of-pocket costs, but yields a contribution of but $12 million, far less than that of bituminous coal.

Q. 13. What conclusion do you draw from the foregoing?

A. I draw the conclusion that the making of rail freight rates on individual commodities is a function which has no direct relation to the costs of the service, except to assure that the rate covers incremental costs. The margin of the rate above the incremental cost floor is a value-of-service and not a cost consideration.

Q. 14. In your judgment, can any so-called full-cost figure serve an economic purpose in the fixing of railroad rates on the separate classes of traffic?

A. I cannot conceive of such a situation. There has been an instance where the Interstate Commerce Commission was interested in the comparative total costs of handling all rail traffic in the respective territories. I refer to Docket No. 28300, Class Rate Investigation.

The Cost Section of the Commission was there asked to make a showing of the relative total cost of rail transportation by rate territories as one of the considerations entering into the determination of the territorial-wide relationship of class rates one territory to another. Such cost data provide no basis for the fixing of any specific rate or charge. This observation is especially applicable to an agency of transportation with a high proportion of costs not capable of allocation except upon value-of-service considerations, and which transports a great range of unlike commodities with widely varying price characteristics, such as the railroad industry.

Q. 15. Do other transporation agencies have a pricing problem similar to that of the railroads?

A. In my opinion they do not. A railroad is unique in that before it turns a wheel or handles a ton of freight it must equip itself at the minimum with an extensive fixed plant consisting of land and right-of-way, road and terminal trackage, roadway structures and facilities, stations, and at least a minimum supply of freight cars and motive power equipment. It also must have a minimum organization to staff the railroad. All costs associated with this minimum plant represent constant costs. The investment is substantially fixed and the overwhelming part of the labor and material charges will be constant.

As volume increases, additional passing tracks, signalling, or eventually a second track, may be added but such physical expansion above minimum plant levels, in my opinion, would not be proportionate to the growth in traffic volume.

In short, I believe that railroads are unique in that they must create and maintain as a minimum a very substantial plant and staff organization as long as a

readiness to serve the public is maintained. Such readiness-to-serve costs are inherently of a constant character and in principle and fact must be set aside in treating with the variable costs. Also, as the traffic expands a more effective utilization of plant and staff is achieved. In short, an increase from one train daily to ten trains daily does not increase the total track structure and other plant facilities, and the staff of employees tenfold. Rail operating costs cannot, in my opinion, be considered as 100 percent variable with added traffic.

Q. 16. Do these considerations lend themselves to the employment of any full-cost concept as the floor to rail rates?

A. In my opinion, they do not. While the constant expenses are to be recovered, they are not recovered under any fixed pro rata ton or ton-mile basis, but rather through rates and charges which recognize the value-of-service considerations pertinent to the movement involved. This is an historic principle in the transportation and other fixed cost industries. Expenses which are of a joint or constant nature must be recovered on the basis of the relative ability of the users to pay. Such costs, indeed, cannot be traced to specific traffic movements on a cost-of-service basis. The response of the shipper to the rates set, commonly referred to as value-of-service considerations, is the critical factor.

Whether the rates applied are properly adjusted to that level above out-of-pocket costs as will maximize the contribution to overhead burden is a rate-making issue and not a cost consideration. The rate-making principles here involved were treated in connection with the showing in Table I above. In the fixing of rates consideration must be given to the ability of the traffic to move, and it is here that the historic factors of value-of-service enter into the pricing of

transportation. The carrier seeks that rate at which the margin earned over out-of-pocket costs, coupled with the volume induced by such rate, produces the greatest aggregate contribution to constant costs. This is a universal principle in pricing under conditions of fixed or joint costs.

Pricing in the railroad and utility fields, and throughout industry generally, where fixed or joint costs are involved, is guided by the universal principle of maximizing net income. Rates are set at the level at which the elasticity of demand, (i.e., reaction of the buyer in terms of quantities of service purchased), will bring the greatest dollar contribution toward the fixed costs and overhead burdens.

Q. 17. Has the staff of the Commission's Cost Finding Section expressed its views on this subject of pricing rail services under conditions of fixed costs?

A. Yes. The Interstate Commerce Commission's release of May, 1962, entitled "Distribution of the Rail Revenue Contribution by Commodity Groups" -- 1960 (Statement No. 2-62), prepared by the Cost Finding Section treats with the critical significance of the out-of-pocket costs to rate-making and the lack of any corresponding significance to the fully distributed costs. To quote:

> "The "fully distributed costs" in this study underlying Table 7 refer to the sum of the out-of-pocket costs and the statistical ton and ton-mile apportionment of constant costs computed as described above. The interpretation to be placed upon these fully distributed costs for rate-making purposes justifies some comment. Rates based solely on the fully distributed costs shown herein would not have the benefit of being guided by that prominent principle of rate making which involves the recognition of derived demand. This principle also is known as differential charging, produce discrim-

ination, or value-of-service pricing. Regardless of terminology, rates made without adherence to this principle will result in reductions on high-grade traffic and concomitant increases on low-grade volume traffic. Historically, rates reflect continuous interplay of economic forces so as to permit all commodities to move with the most reasonable freedom and at the same time contribute as much as possible to the transportation burden. Therefore, the ratios of revenue to out-of-pocket costs shown in Table 7, hereto have a rate-making significance which is not possessed by the "ratios of revenue to fully distributed costs shown in an adjoining column of the same table. Revision of rates to the basis of fully distributed costs would tend to cause volume traffic to move in smaller amounts with a consequent reduction in the contribution to burden which it now furnishes. Thereby an increase in rates rather than a reduction would be placed against the higher-rated traffic"
(Statement 2-62, p.2)

The lack of relationship between "fully distributed costs" and rate levels or rate structures is further indicated by the following Cost Finding statement:

"The term "revenue contribution," as used in this study, refers to the amount by which carload revenues resulting from the rate structure in effect during the year 1960 exceeded or failed to meet the out-of-pocket costs. The revenue contribution shown herein is a function of costs, rates, and volume, and reflects not only cost factors but also the influence of demand for transportation, a value-of-service factor which is independent of direct cost."
(Statement 2-62, p. 1)

Q. 18. Are the statements you have made hereinabove in response to previous questions in harmony with these

statements you have here quoted from the Commission Release 2-62?

A. In my opinion they are.

Q. 19. You have been discussing out-of-pocket expenses. Do the out-of-pocket expenses include an allowance for return on investment?

A. The Rail Form A cost procedures of the Commission provide for the inclusion in the out-of-pocket costs of an allowance for return on the rail plant property and also on car equipment, as the specific occasion requires.

Q. 20. What is your view as to whether it is appropriate in this instance to include a return on road property?

A. The inclusion of return on road property as an out-of-pocket cost depends on whether the instant traffic here involved may be expected to contribute to the expansion of the carrier's plant. It is my understanding that the carriers involved have ample track capacity and, in the past, have carried greater tonnage than they are now able to attract. Under such conditions I do not believe that the incremental costs computed for the involved movement of ingot molds should contemplate expansion of the road plant facilities. In such case the allowance for a return on the roadway facilities should not be considered as a part of the incremental costs in this proceeding. The effect is to reduce the out-of-pocket costs by some 9 or 10 percent.

Q. 21. The employment of incremental costs as a floor has long been a factor in the construction of rail rates that reflect value of service considerations and permit the traffic to move. I here refer to the I.C.C. statement 2-62 showing the Rail Revenue contribution by Commodity Groups. Does the presence of water competition nullify these rate-making principles?

A. In my opinion it does not. The assumption is made by a witness for the Waterways Freight Bureau that under inter-agency competitive situations a railroad should abandon its normal rate-making principles and disregard its own cost characteristics. In short, the rail rates would not be based on the out-of-pocket costs as a floor with such allowance above this level as the value-of-service and market conditions would permit. Rather, the costs would embrace one or other statistical allocations of constant or fixed costs and passenger and LCL deficits. Rates based on costs as thus arbitrarily constructed would operate to exclude the railroads from participation in the involved traffic.

Considerations of the economic capabilities of the railroads to profitably haul traffic at various margins over incremental costs would thus give way to artificial and irrelevant rate-making standards. To sum up, when rail rates are not competitive with water carriers, let us say, the fixed costs of the rails are recognized as a burden to be recovered under rates which will permit the traffic to move. In short, rail rates are set at such levels above incremental costs, all economic factors considered, as will make the maximum contribution toward the fixed costs and burden. On the other hand, if the rates are found to be competitive with a barge carrier, then according to the latter, all normal rail rate-making principles would be set aside and some form of arbitrary, statistical full-cost, ton-mile distributions applied.

The reasons for these contradictory positions may rest on a failure to appreciate the basic economic distinction between rail and waterway cost characteristics. In the briefest terms, it is noted that the rails supply their own roadway plant and facilities all of which would continue irrespective of the instant traffic.

In contrast, government supplies the corresponding rights of way for water carriers. The fixed costs for waterway improvements are borned by the government. No taxes are assessed water carriers for the use of waterways. Water carrier costs approach 100 percent variability.

The railroads have a substantial body of constant costs or burdens, much of which is traceable to fixed plant costs. These costs will exist whether or not the instant traffic is handled. The rail rate-making problem is necessarily that of setting rates which are sufficiently competitive under each set of circumstances to move the traffic and yield a contribution to fixed costs and burden. Making arbitrary, statistical allocations of total system cost requirements is believed to be without meaning in approaching rate-making. The only answer to these rate-making problems is to determine the floor to costs and to add thereto such additional margin as the value-of-service and competitive factors permit. Any other approach would deny the rail carrier of the right to participate in the haul of the traffic in issue.

Q. 22. You have referred to the problem of overstating rail costs in rail-water competitive cases. Would an overstatement of the "break even" or incremental costs be detrimental to the rails?

A. Yes, it could lead to the railroads foregoing traffic which they could, in fact, handle profitably. A reference to Table I hereinabove indicates that for all commodities handled by rail in the United States the margin over out-of-pocket or incremental costs is about 29 percent. A very large volume of rail traffic obviously moves at rates exceeding out-of-pocket costs by small margins. The employment of proper cost concepts, as well as accuracy in determining the incremental costs is essential.

I have explained earlier the circumstances and limited purpose for which fully-distributed costs were initially created, i.e., in resolving broad class rate issues relating to the comparative costs as between major rate territories of the United States (Docket 28300). The employment of fully distributed cost figures in individual rate proceedings would, in my opinion, be somewhat analagous to adding up the prices on the sales tickets for all items of merchandise displayed in a department store and dividing the total by the aggregate tonnage of the merchandise. The resulting average price per ton conceivably might serve some uncertain purpose in comparing the quantity and quality of the goods carried by competing department stores, but it certainly serves no useful purpose in arriving at the appropriate selling price of a particular item of merchandise. Yet I believe this is analagous to injecting territorial average constant costs and return and total regionaal passenger and LCL deficits into the statistical determination of a rate on ingot molds between Neville Island, Pa. and Steelton, Kentucky.

Q. 23 Are you familiar with the testimony of Dr. Baumol, Dr. Buchanan and Dr. Heflebower with regard to the fundamental principles underlying the pricing of railroad freight services?

A. I have read the testimony of these witnesses and I am in full accord therewith. As I interpret Dr. Baumol's testimony the only cost data pertinent to the fixing of a rate is the so-called incremental or additional cost incurred in taking on the specific traffic which is under consideration. A knowledge of these added costs that will be incurred is important for the elementary reason that one does not want to construct a rate that fails to cover the additional costs to be met in handling new business. Certainly, this sets the lower limit of the rate.

Having thus established the floor to the rate at the level of incremental costs one is through with cost-finding insofar as the fixing of the rate is concerned. From this point on, the rate-maker is faced with considerations as to the remaining revenue needs of the railroad.

These revenue needs in the aggregate include the constant or fixed operating expenses of the rail plant. Under the Cost Finding Section's procedures 20 percent of all operating expenses, rents and taxes are treated as constant. There are also in this category allowances for a return on investment for 50 percent of the roadway plant which is treated as a fixed cost. The passenger and LCL deficits are also to be recovered.

The ability of the various classes of freight traffic to contribute toward these general revenue requirements varies greatly as between commodities. The territorial percentage relationships of revenues to out-of-pocket costs by commodity classes and territorial movements range up to 250% or more. Such variations reflect the value-of-service or demand conditions unique to each movemend and each territory.

Q. 24. What interpretation do you draw from these Commission studies which show wide variations in the relationship of revenues to costs?

A. These studies clearly support the economist's view that the only purpose served by costs in rate-making is to establish the incremental cost floor to rates. Beyond this point the rate-maker is guided by the necessity of recovering from each article transported whatever contribution it is capable of making toward total revenue requirements, each market situation considered.

Q. 25. Can this revenue contribution be determined by simply dividing the carrier's total constant and fixed

costs by the total tons or ton miles of traffic handled and adding this statistically derived amount to the incremental costs?

A. My answer is No. It would be rare indeed that such a result would reflect the "ability-to-pay" of the study traffic. Such a procedure would drive away from the railroad great quantities of the low-grade or lower rated traffic such as coal. It would also drive away any higher grade traffic upon which rail rates have had to be reduced to meet the competition of for-hire highway carriers or water carriers or shipper-owned transportation facilities.

On the other hand, much of the contributions now made to the fixed cost burdens by the higher grade traffic now moving freely under the existing rates would be lost. In fact, I do not see how the railroad industry could survive under a system whereby all revenue requirements over and above the incremental or out-of-pocket costs were given some arbitrary statistical prorate over all the tonnage.

Q. 26. What do you visualize would be the effect on the railroad industry under a full application of the fully-distributed cost concept, i.e., the constant and fixed costs and passenger deficits distributed for pricing purposes on some arbitrary ton or ton-mile basis.

A. As I have previously noted, some 65 percent of the total tonnage of the railroads in the United States moves at rates yielding less than fully distributed costs. The application of some version of the "fully distributed" cost concept as a floor to all rail rates would no doubt require rail rate increases of a far-reaching nature. Such increase would be required in spite of the fact that rail rates applicable to every commodity group have been trending sharply downward over the last decade. I here cite the ratio (percent) of the United States carload revenues to out-of-pocket costs for the years 1952, 1956 and 1960.

Ratio (percent) - Carload Revenues to Out-of-Pocket Costs

Commodity Group	1952	1956	1960
Products of Agriculture	137	126	119
Animals and Products	121	112	107
Products of Mines	125	121	109
Products of Forests	132	127	118
Manufactures & Misc.	185	173	152
Forwarded	156	132	119
Total	152	142	129

Source: I.C.C. Statement No. 2-62, Table 3, p. 11

As the above data indicate, the margin of the rates over out-of-pocket costs have been declining sharply for every commodity group.

These figures demonstrate the impact on rail rates of increased competition from other modes of transportation. Between 1951 and 1961 rail freight traffic declined substantially from 655 billion revenue ton-miles to 570 billion. On the other hand, intercity freight traffic by motor vehicle, public and private rose from 188 billion to 305 billion ton-miles. Inland waterways ton miles, including the Great Lakes, rose from 182 billion to 210 billion.[1] The entire growth in the nation's intercity transportation in the last decade has gone to agencies other than the railroads.

In my opinion the application of any program to substitute some fully distributed cost concept for incre-

[1] Interstate Commerce Commission Intercity Ton Miles 1939-1959 Statement No. 6103, I.C.C. Annual Report (1962), p. 12.

mental costs as a floor to railroad rates would result in a heavy diversion of freight traffic to other transportation agencies. Each successive loss of the lower rated rail freight traffic to other agencies of transportation would narrow the traffic volume from which the constant and fixed costs must be recovered with corresponding upward pressure on the rates of the remaining traffic. Such a rate program, in my opinion could lead only to successive losses of traffic with the railroads eventually pricing themselves out of the market.

Q. 27. What is the basic distinction between barge transportation and rail transportation which would permit a water carrier to orient its rates heavily with direct costs, whereas rail rates have historically given consideration to both cost and value-of-service (or demand) considerations?

A. A. primary factor is the difference in cost characteristics. In the case of transportation agencies which do not furnish or maintain their own roadway plant, the expenses vary closely with the volume of traffic handled. In short, the added costs incurred in handling added traffic closely approach total costs.

In contrast, railway transportation is characterized by a large fixed plant with its attendant fixed charges and taxes. Rail transportation is also characterized by a large body of constant or fixed operating expenses or burdens, including the passenger and LCL deficits. The distribution of these burdens to the traffic must rest on the value-of-service or market considerations. To take these fixed costs and burdens and statistically distribute them prorate over the traffic without regard to the effect of the rates so constructed on the movement of the traffic is quite meaningless in my judgment.

Q. 29. Are you familiar with the results of the cost studies made in this proceeding by Mr. Javoronok, Cost Analyst of the Pennsylvania Railroad, and Mr. Charles Bowman, Cost Analyst of the L&N?

A. I am familiar with the findings in these studies, which deal with the costs of ingot molds between Neville Island, Pennsylvania and Steelton, Kentucky. Employing Pennsylvania Railroad and Louisville and Nashville costs, respectively, for each carrier's portion of the haul, an out-of-pocket cost of $4.69 per ton was developed following Rail Form A. procedures. This compares with the proposed rate of $5.11.

Q. 30. Based on these relationships between costs and revenues, are the carriers justified in applying the rate adjustments sought?

A. I believe they are fully justified in their proposed rate action if the added revenues generated exceeds the added costs incurred, a condition which the results of the cost studies show to be met.

The proposed rate of $5.11 exceeds the out-of-pocket costs by 9 percent. In my judgment the inclusion of return on the roadway investment improperly exaggerates the showing of out-of-pocket costs, the roadway plant investment not being affected by the addition of the traffic in question. Excluding road return as an element of out-of-pocket cost, the added cost is $4.27. The proposed rate of $5.11 exceeds this out-of-pocket cost, excluding road return, by 20 percent.

Q. 31. Witness Steiner states at page 4 of his statement that no carrier or group of carriers could operate for very long under a rate structure which merely approximates marginal (out-of-pocket) costs. What is your view on this matter?

A. My view is that a railroad carrier should seek to haul all traffic the revenues from which exceed the incremental cost of carriage. Any other attitude by man-

agement would, in my opinion, be irrational. In this instance the rates exceed the marginal costs by margins that compare closely with those experienced in major traffic groups. (See Table 1, p. 10 hereinabove.)

Railroad revenues and the contributions to constant costs and burdens in particular, are derived from traffic a significant portion of which moves at narrow margins over out-of-pocket costs. It would be irrational for a railroad to overlook the potential contribution to fixed costs and burden which any movement of traffic can generate through appropriate rate adjustments.

Q. 32. Witness Steiner computed so-called "Rail Full Costs" inclusive of total operating expenses, return and recovery of passenger and less-carload accounting deficits. What, in your opinion, is the significance of such cost approach?

A. As I have previously indicated, I believe arbitrary statistical distributions of constant or fixed costs have no economic significance in fixing rail prices. In the transportation market as well as in other markets the price must be set at that level above incremental costs, which will both move the goods and yield the maximum contribution toward constant costs and overhead burdens. This is a matter to be resolved only by market determinations and proper judgment to be exercised in each instance.

Q. 33. In summary, what do you consider to be sound pricing policy for rail transportation?

A. In my opinion, it is essential that the pricing policy for railroads should recognize the cost characteristics peculiar to the railroad industry, namely, the presence of both variable and fixed costs. The function of costs is limited to the determination of a cost floor reflecting the incremental expenses. Considerations of the value of the service or elasticity of demand

will basically determine the margin above such floor at which rates should be established. The fully allocated costs in my opinion serve no purpose in the rail rate-making process.

Exhibit No. 41

I. & S. Docket 8
Witness: Finley
Exhibit No. 41

STATEMENT OF JOHN D. FINLEY

My name is John D. Finley. My service in The Pennsylvania Railroad Company Traffic or Sales Departments dates from 1929, and over 25 years of this period have been spent in Freight Rate work. I have been Assistant General Manager-Freight Rates since 1955.

During the 35 years since 1929, there has been an almost complete change in the pattern of rail traffic. When I first started in rate work, competition with other forms of transportation was slight, almost non-existent except in the limited areas where barge, alke or coastwise steamer operations or pipelines existed. The criteria of rate making then employed by the railroads were totally different from those of today. In that period, with the absence of competition, primary emphasis was laid on the usual classification principles for fixing rate levels, such as value of the commodity. Where the I.C.C. or state commissions had prescribed maximum rate levels on certain heavy moving commodities, both in bulk and in other than bulk, these were also in fact minimum rates on which the volume of traffic moved, as there was no effective competition.

In contrast, today in no area of railroad traffice is there any "captive" business. Competition in one or more of many forms has penetrated the full range of rail traffic. There seems to be the misconception that certain kinds of

freight must move by rail at rates which are not influenced by competition. To whatever extent this may have been the case in past years, it most definitely is no longer true. Competition is not limited only to other forms of transportation—truck, water or pipeline. It is manifested in economic pressures which may be in the form of substitute materials available at lower laid down cost; or it may be in the form of forcing transfer of plants to be near new sources with lower transportation cost; or it may lead to decentralization of industry in a program to reduce transportation as a controllable cost. In virtually all rate proposals today, excluding those involving technical tariff problems relating to the provisons of the Tariff Circular or Sections of the Act, one or more of these competitive influences will be found.

Island to that point in a plant-to-plant movement.

There is a regular movement of these commodities from Neville Island, Pa., to Steelton, Ky. in lots of 600 gross tons, which are transported via barge from origin to Owensboro, Ky., and there transferred to trucks for handling to the plant at Steelton. Except for an occasional single car of urgently needed molds, this traffic is now moving exclusively by barge to Owensboro on basis of a total cost of 511 cents per gross ton, arrived at as follows:

	Rates and Charges in Cents Per Ton 2,240 Pounds
Barge handling to Owensboro, Ky. (By Mississippi Barge Line)	332 (Min.Wt. 600 tons of 2,240 pounds)
Transfer from barge to truck (By Owensboro River-Rail Terminal)	95
Truck handling Owensboro to Steelton (By Parr Trucking Service, Inc.)	84
Total	511

Authority For Barge Rate - Mississippi Valley Barge Line Co. Frt. Tariff 25-I, ICC 110.

Authority For Truck Charge - Charge of $15.00 per hour, which averages 84 cents per ton of 2,240 pounds, based on the tonnage handled and time consumed in such handling.

The present rail rate on this traffic is 1059 cents per 2,000 pounds (or 1186 cents per 2,240 pounds) as shown in Exhibit (2), and the shipper definitely advised that unless an all-rail rate is established which equals the cost to the shipper of 511 cents per 2,240 pounds when movement is via barge-truck, the rail lines will not participate in the movement of this traffic.

Steelton, Ky. is a local station on the L. & N. RR. and the Green River Steel Corporation plant at that location has a private siding. In

EXHIBIT 3

by the Owensboro River-Rail Terminal Company at Owensboro, Kentucky. Transfer from barge to truck at the docks is made by crane operated by the Owensboro River-Rail Terminal Company. Delivery at Steelton is by for-hire truck.

The charge for unloading from barge at Owensboro by the Owensboro River-Rail Terminal into trucks is 85 cents per net ton. The charge for the movement by commercial truck from the River Terminal at Owensboro to the steel company's plant at Steelton is $15.00 per hour per truck, which averages 84 cents per gross ton based on the tonnage shipped and trucking charges assessed. This is seen from exhibits filed with the protest, being reproductions of a freight bill of the Mississippi Valley Barge Line covering a shipment of June 29, 1963, weighing 1,463,730 pounds and a shipment of March 30, 1963, weighing 1,397,780 pounds, and letters from Owensboro River-Rail Terminal and Parr Trucking Service, Inc.

This traffic normally moves exclusively by barge in connection with truck delivery. In isolated instances production schedules have required a rush order of single carloads which have been routed by railroad. If the railroads are to participate substantially in the movement, it will be necessary to have a rate not exceeding the total costs to the Green River Steel Corporation of the present method of handling. The proposed rate will enable the rail carriers to do so. This, of course, contemplates normal common carrier service by rail. If the proposed rate is approved and becomes effective, this company will allow the railroads to share in this business. It would be our purpose to use the short line route of the Pittsburgh, Chartiers & Youghiogheny—

Pennsylvania Railroad to Cincinnati and the Louisville and Nashville Railroad to destination.

VERIFICATION

I solemnly declare that I have examined the foregoing statement and that the representations contained therein are true.

Joe C. Westerfield

EXHIBIT 13

American Commercial Barge Line Co., at the time the protest was filed had reported it had not handled any of this particular traffic. It was requested to check this matter for inclusion in my later Exhibit 16 through the year 1963. It was physically unable to do so because recent flooding on the Ohio River at its Jeffersonville, Ind: office where its records are kept caused a temporary closing of that office and removal of personnel to a Louisville location. Its records are not available to it at this time.

Exhibit 15 shows the consist of traffic handled by all the Bureau members in the year 1962 based on individual reports to the Bureau. The assembly of these statistics is explained on the reverse side of the Exhibit. It will be noted that Iron and Steel, which includes Class 579 in which the carriers report ingot molds for statistical purposes, was the third most important commodity grouping available to barge service, accounting for 10.81% of their total 1962 revenues. Also to be noted is the fact that the barge carriers depend upon 11 commodity groupings for 81.45% of their total 1962 traffic revenues.

Exhibit 16 is a statement showing the total tons of ingot molds transported by the members of Waterways Freight Bureau, by years, for the last 11 years, from Neville Island, Pa. to Owensboro, Ky.

During my service with a single barge line or as Chairman of the Bureau, having contact with actual or prospective shippers, I have never encountered a situation in which a shipper has not insisted upon a showing that he would save money by using barge service, as the predicate for a rate. And when I refer to a money saving, I mean that the overall or ancillary costs attached to the use of barge service must be lower than those attached to the rail service entailed in the same undertaking. Even in cases where shippers discount the greater value of rail service and assure the Commission they will "divide" the traffic both rail and barge at a parity of rates, it does not work out that way. For example, in *Iron or Steel Slabs from Cincinnati to Riverdale*, 308 ICC 151 (July 20, 1959), a case involving these same barge lines, the Commission observed from that record that the total barge transportation charges asserted by the shipper were $7.13 per ton (pg. 152). The protested all-rail rate in that case was $7.13 per ton. The shipper witness there testified, as recounted at page 152-153 of the ICC report:

> "This witness further testified that time in transit by barge approximates 18 days, in comparison to 9 days by rail, and as ample storage facilities are available at origin and destination, neither the 500-ton barge minimum nor the extra time in transit is of importance. The controlling factor in the selection of a transportation agency, according to this witness, is costs, and unless costs are qualized by rail, he has no alternative but to route the traffic by the cheapest mode available, which as shown, is by barge. However, if the proposed rate is permitted to become effective, he has promised a 50-50 apportionment between rail and barge."

In permitting the rail rate in the "Slabs" case which matched the total barge charges, the ICC made a finding (page 155):

> " . . . that at equal rates both will receive an equal portion of the traffic."

"Both" referring to 1), the rail lines and 2), the barge lines. Exhibit 17 shows the barge movement of slabs, by years, from Cincinnati-Newport to Riverdale, before the parity of rates was permitted, and after. Our information is that the movement still exists. Obviously the rails have it all. Exhibit 17 shows that there has been no movement by barge since 1962.

Ordinarily, the shippers who use barge service are the larger industries capable of handling traffic in large consignments of 300 tons, or more. Almost invariably these shippers as well as their receivers have private or individual sidings. If they also have barge docking facilities at each end of the haul, the comparison between the costs to the shipper of all-rail service and barge service is relatively simple. On the rail side, the cars are spotted at the shippers siding where he loads the freight into the car. At the destination end the shipper unloads the car which is spotted on his private siding. On the barge side, the published rate ordinarily, and in the instant case, applies only from in barge at origin to in barge at destination. The shipper must load the barge at origin at his expense and the consignee must unload at his expense. In that situation, the true comparison is between the all-rail rate, as such, and the barge rate plus the difference, if any, in the cost of loading and unloading, rail cars versus barge.

In situations where industry tracks at origin or destination, or both, are situated away from the water carrier's dock, the shipper in figuring overall costs to him, will add to the barge rate the costs incident to switching or trucking to and/or from the barge dock, in determining whether he will save money. If the origin or destination, or both, make a line haul necessary beyond the port, the line haul cost for rail or truck service must be added to the barge rate.

Thus far I have referred to differences in transportation charges which affect the shipper and which can be accurately pinpointed. There are other differences which are of an im-

ponderable nature but which shippers take into account in choosing between competitive routes. In the instant case, for example, the rail movement will be in 12-car lots involving a single bill of lading and a single loading receipt. At destination only one plant unloading receipt will be necessary. The barge movement, by way of contrast, requires a barge dispatch, an unloading of the barge away from the plant, and a trucking operation requiring multiple trips, receipts, etc. While these things cannot perhaps be measured in arithmetic precision, they are factors which, in our experience, are constantly called to our attention as differences in transportation conditions which must be reflected in the barge rate. The barge rate is the only factor of the total charges over which the barge carriers have control.

Also, of course, is the matter of relative transit time. As other witnesses will show, in detail, the transit time involved in barge service is much longer than for rail service, a factor which also influences the shipper in his choice of routes. Other witnesses will deal with such operating details.

EXHIBIT 18

STATEMENT OF M. C. PEARSON IN I.&S. DOCKET 8038, INGOT MOLDS TO STEELTON, KY.

My name is M. C. Pearson. I am employed by the Mississippi Valley Barge Line as their Traffic Manager-Rates, at 411 North 7th Street, St. Louis, Missouri 63101. My employment with this company commenced in the Traffic Department on December 1, 1931, and I have held my present position since July 1, 1940.

The Mississippi Valley Barge Line is certificated under Docket No. W-78, as amended, issued by the Interstate Commerce Commission, to serve practically the entire Mis-

sissippi River Waterway System, including the Ohio, Allegheny and Monongahela Rivers. The shipper's dock at Neville Island is 7.1 miles below Pittsburgh, Pa., on the Ohio River and Owensboro, Kentucky is 756.5 miles below Pittsburgh on the Ohio River. We operate a regular service on the Ohio River and its tributaries and participate in the barge movement of Ingots and Ingot Molds from Neville Island to Owensboro.

My duties as Traffic Manager-Rates include the negotiation of rates with shippers and receivers, and the publication and maintenance of rates which are filed with the Interstate Commerce Commission. In my many years of experience in making rates for my company, I have found that our primary competition is the railroads, and that in order to compete with them we must be able to demonstrate to our customers that they will realize some savings in using the barge route, because the comparatively inferior and slower service of the barge route is attractive only if offset by an accompanying saving in transportation costs. We have never, to the best of my knowledge, been able to secure or retain traffic when the total over-all charges when compared with all-rail did not result in substantial savings. Some of the factors that shippers raise as their justification for demanding a saving via the barge route are:

1. Adequate storage space at origin plant to accumulate tonnage to meet bargeload minimum requirements.
2. Investment involved in maintaining such facilities and a large inventory.
3. Extra handling of the article shipped generally accompanying a movement as compared with rail.
4. Risk of loss and damage resulting from these additional handlings.
5. Proximity of rail sidings to plant normally require no extra movement of cars, whereas a switch movement is generally required to a barge loading facility.

6. Transit time via barge route is much longer than via rail with a consequently higher inventory expense.
7. Adequate storage space at destination plant to receive bargeload lots at one time.
8. The cost of maintaining such storage space and large inventories.
9. Lack of flexibility generally accompanying use of barge route, such as dove-tailing origin plant and destination plant operation for the maximum efficiency.

Exhibit 19 hereto is a copy of Fifth Amended Certificate in Docket W-78, which shows the complete operating authority of the Mississippi Valley Barge Line Company.

Exhibit 20 hereto is a chronology of bargeload rates of the Mississippi Valley Barge line on Ingot Molds and Ingot Mold Stools from Neville Island, Pa., to Owensboro, Ky. (Steelton) commencing with January 1, 1953. Except for some minor differences in effective dates, the rates of the other common carrier barge lines are the same.

Exhibit 21 hereto is a statement showing the over-all charges via the barge route on Ingot Molds and Ingot Mold Stools from Neville Island, Pa., to Steelton (Owensboro), Ky., together with the proposed rail rate of $5.11 per gross ton.

The Mississippi Valley Barge Line has participated in the movement of Ingot Molds and Ingot Mold Stools from Neville Island, Pa., to Owensboro, Ky., since the inception of the Green River Steel Corporation plant at Steelton in 1953. While this movement might not be considered substantial when compared with other movements in which we participate, it is nevertheless an important one to us and its loss would be hurtful. This is a port to port movement and is the type on which we must rely for our bread and butter if we are going to survive as a common carrier by water.

I have made a study of our movements of Ingot Molds and Ingot Mold Stools for the years 1962 and 1963 and

find that the average transit time for moving barges from Neville Island to Owensboro was approximately 8 days. This does not include the time for loading the barges; the lay time at origin awaiting pickup by our towboat; and the time consumed in unloading at Owensboro.

There is no question in my opinion, based on past experience, that if the proposed rail rate of $5.11 per gross ton is allowed to become effective, our route would not be used for this movement at the present level of rates. To reduce the barge rate to a level that would continue to make the slower barge route attractive would require us to establish a rate substantially below our fully distributed cost. This, we believe, we should not be forced to do, particularly when the barge route is the low-cost route when fully distributed costs of barge vs. rail are compared.

I have read the statement of Mr. Joe C. Westerfield, General Traffic Manager of the shipper that:

> If the proposed rate is approved and becomes effective, this company will allow the railroads to share in this business.

From my experience the railroad "share" will be 100 per cent. I make this statement for two reasons: First, this particular shipper was using barge service on another commodity on which he incurred overall costs below those incident to all-rail service. We have not had this movement since the rail lines reduced their rate to a level below the overall charges via barge effective October 22, 1963. I cannot, therefore, conceive of him using barge service on a parity of rates in this particular instance. Secondly, we have had instances in which shippers on the witness stand have asserted that they would divide traffic between barge routes and rail routes on a parity of costs. One particular instance comes vividly to mind.

In Fourth Section No. 34540 Iron or Steel Slabs from Cincinnati, Ohio and Newport, Kentucky to Riverdale, Ill., reported at 308 I.C.C. 15, authority was granted rail lines

to establish and maintain a rate of $7.13 per ton of 2,240 pounds for the transportation of Slabs, Iron or Steel, unfinished, in carloads, minimum 100,000 pounds from Cincinnati, Ohio and Newport, Kentucky to Riverdale, Ill., and to maintain higher rates from and to intermediate points. The report in this proceeding will show that the rate of $7.13 per ton of 2,240 pounds equalized the overall charges via barge and at pages 152-153, 308 I.C.C. the following statement is made:

> "The controlling factor in the selection of a transportion agency, according to the witness, is costs, and unless costs are equalized by rail, he has no alternative but to route the traffic by the cheapest mode available, which as shown, is by barge. However, if the proposed rate is permitted to become effective, he has promised a 50-50 apportionment between rail and barge."

The rail rate of $7.13 became effective on August 28, 1959. We had no movement via our line after that date in 1959; no movement in 1960; a small movement in May and June of 1961; and a movement in the months of January, March, April and May of 1962. We have had no movement since that time, despite the fact that we published a reduced rate of $5.00 per ton of 2,240 pounds from Cincinnati, Ohio and Newport, Ky., to Chicago (Riverdale), Ill., effective January 1, 1964. Using the incidental costs at origin and destinations shown at page 152 of 308 I.C.C., the overall costs via barge under the new rate would aggregate $5.78 per ton of 2,240 pounds as compared with the present rail rate of $7.24 per ton of 2,240 pounds published in C.T.R. Tariff 434-E, I.C.C. No. 3388.

A division of traffic under a parity of costs is simply not in the cards.

I have had an opportunity to read the statement of Robert M. Tyrie on behalf of Union Barge Line and what he says as to the physical aspects of barge transportation and equipment applies equally to our line.

EXHIBIT 20

CHRONOLOGY OF BARGELOAD RATES ON INGOT MOLDS AND INGOT MOLD STOOLS FROM NEVILLE ISLAND, PA., TO OWENSBORO, KY., COMMENCING WITH JANUARY 1, 1953.

Date	*Rate per Gross Ton*	*Minimum Weight (Gross Tons)*
January 1, 1953	$2.84	500
March 23, 1955	2.70	500
December 1, 1955	2.70	500
May 1, 1956	2.86	500
March 15, 1957	3.00	500
November 6, 1957	3.12	500
July 1, 1959	3.12	600
November 1, 1960	3.32	600
January 1964	3.32	600

Tariff Authorities:

M.V.B.L. 25-B, I.C.C. 97
M.V.B.L. 25-C, I.C.C. 101
M.V.B.L. 25-D, I.C.C. 103
M.V.B.L. 25-E, I.C.C. 104
M.V.B.L. 25-F, I.C.C. 107
M.V.B.L. 25-G, I.C.C. 108
M.V.B.L. 25-H, I.C.C. 109
M.V.B.L. 25-I, I.C.C. 110

EXHIBIT 21

STATEMENT SHOWING OVER-ALL CHARGES VIA THE BARGE ROUTE AND THE PROPOSED RAIL RATE ON INGOT MOLDS AND INGOT MOLD STOOLS FROM NEVILLE ISLAND, PA. TO STEELTON (OWENSBORO), KENTUCKY.

	Rate or Charge (Per Gross ton)
Barge line-haul rate–Min. Wt. 600 G.T.	$3.32 (1)
Transfer from Barge to Truck at Owensboro	.952 (2)
Trucking to Plant of Green River Steel Company	.85 (3)
Total	$5.122
Proposed Rail Rate	$5.11

(1) Tariff Authority: ACBL I.C.C. No. 9, MVBL I.C.C. No. 110, ORC I.C.C. No. 15, UBL I.C.C. No. 22.

(2) Owensboro River-Rail Terminal rate of 85 cents per net ton converted to a gross ton basis.

(3) Parr Trucking Service, Inc., average per gross ton based on actual charges made for trucking two bargeloads of Ingot Mold and Stools in March and June 1963.

EXHIBIT 22

Statement of J. Paul Toner

* * *

I cannot recall any instances in which our company was able to participate in any business on a parity of rates, which would include accessorial rates, in competition with all-rail rates from and to the same customers. In this respect our experience is the same as that described by Mr. Pearson and Mr. Tyrie.

EXHIBIT 25

Statement of Robert M. Tyrie

* * *

Marked for identification as my Exhibit 30 is a statement showing the chronological history of railroad carload rates on Ingot Molds from Neville Island, Pa. to Steelton, Ky. This exhibit clearly demonstrates that the rate was reduced from $14.93 per gross ton to $11.18 per gross ton on September 5, 1958. Another reduction from $11.28 per gross ton to $10.59 per gross ton was made effective February 10, 1963.

Another statement, marked for identification as my Exhibit 31 is a statement showing the railroad carload rates on Ingot Molds from representative origins to representative destinations. This statement shows the Docket 28300 miles and the percent that the rail rates are of the First Class rates. With the exception of the water competitive rate from Neville Island, Pa. to St. Louis, Mo., and from Pittsburgh, Pa. to Chicago, Ill., the rail rates range from 17.5 percent to 27.0 percent of First Class. The present rate from Neville Island, Pa. to Steelton, Ky. is 16.1 percent of First Class and the rate under suspension is only 6.9 percent of First Class.

Iron and steel articles represent one of the most important commodities handled by Union Barge Line Corporation. As our Annual Report for the year 1962 to the Interstate Commerce Commission (Form K-A) will reveal, these commodities represented about 24 percent of our total tonnage and about 43 percent of our total revenue. For that reason, I am vitally concerned with any downward adjustment in the freight rates on iron and steel articles by competitive modes of transportation.

As a general proposition, I know that barge lines cannot expect to handle traffic when the overall charges via the barge route are at or near a parity with the charges via the rail route and certainly barge lines cannot compete when

rail rates are lower than the overall charges by the barge route. In other words, unless we are able to demonstrate a savings in freight charges to the shipper, he will not use our services. Even on a parity of charges the barge line is at a disadvantage because of its inferior service. Operating against us in these situations are such factors as our heavier minimum weight requirements, our less frequent sailings, our slower transit time and our unanticipated delays resulting from fog, ice and high or low water conditions, to say nothing of the added expense and inconvenience of multiple handling over the barge route. Other factors which the shipper takes into consideration in the choice of modes include, among other things, such items as increased interest on investment on the larger volume shipment and increased interest on investment resulting from the slower transit time. These are known factors which shippers take into account whenever they have to make the determination of whether a shipment will be moved via the barge or rail routes. Whenever a study is made of the charges via the barge route, the shipper also takes into consideration the excess cost of loading barges versus rail cars and the charges for moving the shipment to and from the barge loading and unloading ports.

As I indicated earlier, if the overall charges by the barge route are not less than the charges via all rail, the shipment will be routed all rail because there is no advantage to the shipper in routing his shipment by the more expensive barge route.

I will admit that there are isolated instances where shippers will divide their shipments between barge and rail when the overall charges are on a parity but, in all of my experience, I know of not a single ingot mold that has moved by barge when the overall charges were the same as, or more than, the charges by rail between the same points. Except where the shipper has a most peculiar marketing or production problem, giving rise to some latent advantage, Union Barge Line Corporation cannot expect to participate in the movement of any commodity by barge unless our overall

charges are differentially lower than the charges by rail. As I have said, such is a most remote possibility in the movement of ingot molds.

In cases where the railroads have reduced their rates to eliminate that differential, we have lost the traffic completely to the railroads. Examples of such loss of traffic are: Pipe Coating Material from Neville Island, Pa. to Louisville, Kentucky; Sugar from New Orleans, Louisiana to Evansville, Indiana; Scrap Iron from Chicago, Illinois to Weirton, West Virginia; Sugar from New Orleans, Louisiana to Pittsburgh, Pa.; Tinplate from Pittsburgh, Pa. to Tampa, Florida; and I could continue to cite examples ad nauseum.

Under no circumstances is a shipper willing to pay us a premium for our service and the amount of the differential that is required to permit the barge lines to compete effectively will vary from one shipper to another and from one commodity to another depending always, of course, upon the traffic management policies of the involved shipper.

Exhibit No. 30

I&S Docket No. 8038
Exhibit No. (E) 30
Witness: Robert M. Tyrie

STATEMENT SHOWING CHRONOLOGICAL HISTORY OF CARLOAD RATES ON INGOT MOLDS FROM NEVILLE ISLAND, PENNSYLVANIA, TO STEELTON AND OWENSBORO, KENTUCKY

Rates in dollars per net ton, except as noted

	Basic Rate	Increased Rate	Authorized Increase	Minimum Weight
*April 15, 1954	$ 10.49	$ 12.06	15% X-175-B	50,000 lbs.
December 20, 1955	10.49	12.06	15% X-175-C	50,000 lbs.
March 7, 1956	12.06	12.78	6% X-196-A	50,000 lbs.
December 28, 1956	12.78	13.42	5% X-206	50,000 lbs.
August 26, 1957	12.78	13.93	9% X-206-A	50,000 lbs.
February 15, 1958	13.93	14.93	$1.00 NT X212	50,000 lbs.
September 5, 1958	10.18	11.18	$1.00 NT X212	100,000 lbs.
October 24, 1960	11.18	11.28	$ .10 NT X223	100,000 lbs.
February 10, 1963	10.59	10.59	---	100,000 lbs.
November 15, 1963	10.59	10.59	---	100,000 lbs.
	5.11[1]	5.11[1]		112,000 lbs.[2]

[1] Rates in dollars per gross ton.

[2] Applies only when shipped under one bill of lading from one consignor at one origin to one consignee at one location at one destination in one day, subject to an aggregate minimum weight of 600 tons of 2,240 pounds, each car to be loaded to a minimum weight of 112,000 pounds.

* Prior to April 15, 1954, commodity took class rates, i.e., class 32½ or 44 cents per 100 pounds subject to general increases as made effective subsequently, such as X-148, X-162, etc.

TARIFF AUTHORITIES:

TLTTB E/S 145-D	ICC A-968
TLTTB E/S 145-E	ICC A-1079
TL-CTRTB E/S 738	ICC C-334

Exhibit No. 32

STATEMENT OF DELBERT M. STEINER

My name is Delbert M. Steiner. I am a transportation economist specializing in the analysis of cost, traffic, and statistical data. I received a Bachelor of Science in Commerce in 1940 from the College of Commerce of the University of Iowa and the degree of Master of Arts in 1959 from American University in the fields of economic theory and transportation economics.

I have been engaged in the analysis of transportation cost, traffic, statistical, and other economic data for the past twenty-two years. For the last five years, as a private transportation consultant, I have appeared before this Commission and state regulatory agencies on behalf of various railroads, motor carriers, water carriers and users of transportation services. During the preceding five years, I was employed by the Post Office Department as senior postal rate economist, responsible for the review and analysis of parcel post rates and services, and for preparation of recommendations for reformation of rates and conditions of mailability of fourth-class mail matter. Between 1950 and 1954, I was employed in the Office of the Secretary of Defense as Chief of Statistical Analysis and Economic Evaluation for the Military Traffic Service, and was responsible for the direction of statistical and economic programs concerning the transportation of both persons and mat[illegible]. I was employed as a transportation cost analyst w[illegible] the Cost Finding Section of this Commission from 1946 to 1950. It was during these years that the general form of many of the motor carrier and railway cost formulae and studies were developed.

I also served as a full-time consultant to the Transportation Task Force of the Commission for the Reorganization of the Executive Branch of Government, more commonly called the Second Hoover Commission.

I

The Waterways Freight Bureau has asked me to review the cost data introduced by the rail cost witness and from them determine the Rail Full Cost of moving ingot molds from Neville Island, Pennsylvania, to Steelton, Kentucky. ton, Kentucky.

The out-of-pocket cost data as developed by the rail cost witnesses has been accepted by me in Part II of this statement for the limited purpose of determining the Rail Full Cost using their operating factors and cost adjustments.

My serious reservations in limited accepteance of these cost data is discussed in Part III of my statement. My use of the out-of-pocket cost developed by rail cost witnesses should not be construed as accepting them as any reasonable approximation of the rail cost of moving ingot molds traffic between Neville Island and Steelton.

II

The railroads propose to establish a rate of 511 cents per gross ton (2,240 pounds) for the movement of ingot molds from Neville Island, Pa., to Steelton, Ky., applicable on a minimum movement of 600 gross tons in not less than 12 rail cars. Although the railroads intend to apply this rate over a number of routes, they have introduced the out-of-pocket cost for this movement over only the short-line route, i.e. PC&Y (Duffs Jct.) PRR (Cincinnati) L&N. The distance for this short-line route is 531 miles. (PC&Y, 7 miles; PRR, 304 miles; and L&N, 220 miles). Other practical routes would be from 21 miles to 74 miles more distant and would generally involve a greater number of interchanges.

Out-of-pocket costs for movement of ingot mold traffic over this short-line route were prepared by two rail witnesses. Witness Javoronok prepared the out-of-pocket costs covering the movement from origin to the Cincinnati interchange, and Witness Bowman from the Cincinnati interchange to destination.

Each witness prepared an estimate of the out-of-pocket cost using territorial level costs for the year 1961 and a second estimate using a Rail Form A application to their own companies for the year 1962.

For the purpose of discussion we shall use the costs as prepared by the rail witnesses, but with serious reservations as to whether they properly reflect out-of-pocket costs actually incurred in handling ingot mold traffic.

Out-of-pocket costs prepared by the two rail cost witnesses are shown in the following table.

Table 1

Movement	Out-of-Pocket Cost per Gross Ton	
	Territorial 1961	Individual Carrier 1962
(1)	(2)	(3)
1. Neville Island - Cincinnati	338¢	331¢ *
2. Cincinnati - Steelton	145¢	138¢
3. Total	483¢	469¢

* Movement on PC&Y Ry. at Eastern District Cost for 1961

The proposed rate of 511 cents exceeds the 1961 territoral out-of-pocket costs prepared by the rail cost witnesses by 28 cents or less than 6 percent. The proposed rate exceeds the 1962 individual carrier out-of-pocket costs as prepared by the rail cost witness by 42 cents, less than 9 percent. The data submitted by the rail cost witness would tend to indicate that the cost levels as a whole for the individual carriers do not differ significantly from the territorial levels of cost. The difference between the two methods used is less than 3 percent.

Both rail cost witnesses limited their preparation of cost data to the out-of-pocket level of cost and to the short-line route. No consideration was given to other elements of cost.

Neither rail cost witness drew any conclusions as to whether the extremely narrow margin between the proposed rate and out-of-pocket cost was an adequate contribution to rail constant cost for either carload traffic generally, for ingot mold traffic as a whole, for traffic moving between Pittsburgh and Owensboro areas, or, for the specific traffic here under investigation.

It is obvious that no carrier or group of carriers could operate for very long under a rate structure that merely approximates marginal (out-of-pocket) cost. Such a rate structure would not be substainable over a period of time, unless the marginal costs were the equivalent of full costs. The rail out-of-pocket costs which have been introduced by the rail cost witnesses are based upon 80 percent of operating expenses, rents and taxes; and 4 percent return on investment in equipment but on 50 percent of road investment.

There are at least four basic methods for determining Rail Full Cost, giving consideration to all costs which must be fully recovered by the railroad if they are to continuously provide transportation service.

(1) *Distribution of Rail Constant Costs on Basis of Service Units*

Recovery of 20 percent of operating expenses, rents and taxes and a 4 percent return on the remaining 50 percent of road investment represents the constant cost or transportation burden to be recovered by the railroads. In addition, rates on lcl and passenger traffic fail to recover the full cost allocated to those services. The extent to which railroads are fully recovering these constant costs from a given movement of traffic can be determined by comparing the margin between the rate and out-of-pocket cost for such a movement with the ton and ton-mile distribution of these constant costs as provided in Rail Form A. Rail Form A is the cost formula used by the rail cost witnesses in preparing the out-of-pocket costs.

The ton and ton-mile distribution of the rail constant cost as provided in Rail Form A for Eastern District and South-

ern Region for the year 1961 are developed in my Exhibit No. 33 (DMS-1) for ingot mold traffic under investigation.

Table 2

Description	Rail Territorial Cost 1961		
	East	South	Total
(1)	(2)	(3)	(4)
1. Rail Out-of-Pocket Costs	338.3 ¢	145.2 ¢	483.5 ¢
2. Rail Constant Cost *	177.4 ¢	98.5 ¢	275.9 ¢
3. Rail Fully Distributed Cost	515.7 ¢	243.7 ¢	759.4 ¢

* Rail Form A Distribution on ton and ton-mile basis.

There are numerous alternative ways in which rail constant costs may be distributed upon the basis of service units to determine a Rail Form A oriented "fully distributed" cost. Among these are:

(a) Car and car-mile basis similar to the Rail Form A ton and ton-mile basis.

(b) Number of carloads originated and terminated.

(c) Number of loaded car-miles.

(d) Number of loaded and empty car-miles.

(e) Number of tons originated and terminated.

(f) Number of net ton-miles.

(g) Constant Costs as a percentage of out-of-pocket cost separately for line haul and terminal.

(h) Constant Costs as a percentage to out-of-pocket cost without regard to line haul and terminal.

These allocations of constant costs are compared in the following table. Column (5) is an index with Rail Form A ton and ton-mile distribution of constant cost equalling 100.

Table 3

Method of Apportionment	Constant Costs Per Gross Ton			
	East	South	Total	Index
	(cents)	(cents)	(cents)	(percent)
(1)	(2)	(3)	(4)	(5)
Rail Form A	177.4	98.5	275.9	100
(a)	109.6	68.2	177.8	64
(b)	97.5	71.5	169.0	61
(c)	119.3	66.4	185.7	67
(d)	126.3	76.4	202.7	73
(e)	120.3	82.8	203.1	74
(f)	191.8	104.7	296.5	107
(g)	134.3	67.6	201.9	73
(h)	131.8	63.5	195.3	71

The lowest "fully distributed" cost of these Rail Form A oriented bases for the distribution of constant costs would result from use of a carload basis. This would produce a "fully distributed" cost of 652.5 cents per gross ton as compared with a revenue of 511 cents.

(2) *Distribution of Rail Constant Cost on basis of Revenue Need*

Rail constant cost may be computed as the revenue needed above Rail Form A out-of-pocket cost to fully recover the current volume of carload revenues. This average "carload revenue need" for the year 1961 is computed for Eastern District and Southern Region in my Exhibit No. 34.

Rail Full Cost for the movement of ingot molds can be determined by increasing the out-of-pocket costs as developed by the rail cost witnesses by the carload revenue need, the ratios shown on line 7 of my Exhibit No. 34 (DMS-2).

Table 4

	Rail Full Cost per gross to -cents-		
	Out-of-Pocket	Revenue Need	Total
(1)	(2)	(3)	(4)
Movement in Eastern District	338.3	1.209	409.0
Movement in Southern Region	145.2	1.433	208.1
Total Movement	483.5	-	617.1

Revenue contribution, the amount by which a rate exceeds out-of-pocket cost, may be compared with the distribution of constant cost to determine the relative revenue contribution. In table 5 the rail revenue contribution from proposed rate is compared with the distribution of rail constant costs.

Table 5

Description	Cents per gross ton
(1)	(2)
1. Proposed Rate	511.0
2. Territorial Out-of-Pocket Cost	483.5
3. Revenue Contribution	27.5
Constant Cost Distribution	
4. - Rail Form A - ton and ton-mile	275.9
5. - Rail Form A - carloads	169.0
6. - Revenue need	133.6

Revenue contribution of the proposed rate, 27.5 cents, would be about 10 percent of the conventional ton and ton-mile distribution of constant costs; 16 percent of the carload distribution; and 21 percent of the average current revenue need.

(3) *Average Total Cost including Return on Investment and Operating Deficits*

Rail Full Cost is also average total cost. It may be determined directly without first computing out-of-pocket cost and allocating constant cost on the basis of out-of-pocket costs (even though the results may be similar). Average total cost consists of operating expenses, rents and taxes, 4 percent return on investment (after federal income taxes), and accounting deficits from operation of rail passenger and less-carload services.

Average total cost is long term marginal (variable) cost in the true classical economic sense. This is a realistic economic framework within which to determine low cost carriage, the most economic allocation of national resources

directly purchased and used by each of the competing modes of transportation. This economic level of cost is particularly appropriate where the modes of transportation have significantly different cost structures. Holding any cost fixed in economic analysis assumes that prior investment in national resources must be protected. The consequence of such an economic policy would be to perpetuate that carrier which has made the greatest prior investment in national resources without regard to the most economic utilization of resources.

Rail Full Costs have been prepared using average total cost (Total operating expenses, return and recovery of passenger and less-carload accounting deficits) allocated to the Rail Form A, Schedule G Expense Groups. Witness Javoronok's 1961 Eastern District costs have been restated on this basis as have the 1961 Southern Region costs introduced by Witness Bowman. The average total costs for the movement of ingot molds from Neville Island to Steelton, using the methods and operating factors employed by the rail cost witnesses are:

Table 6.

Movement	Average Total Cost per Gross Ton
(1)	(2)
Within Eastern District	475.0 cents
Within Southern Region	212.9 cents
Total Movement	687.9 cents

The detail for these costs are shown in my Exhibit No. 35. The accounting deficits from passenger and less-carload service have been treated as an overhead expense.

Witness Rozaitis determined the average total barge cost including a 4 percent return on investment (after Federal Income Taxes) of 339.7 cents per gross ton. To this amount has been added 180 cents per gross ton as the consignee's

switching and handling costs. Thus, the average total barge cost of 519.7 cents per gross ton is directly comparable to the average total rail cost of 687.9 cents per gross ton.

(4) *Average Total Cost including Average Revenue Need*

Rail Full Cost must include provisions for recovering operating costs as well as the cost of capital dedicated to the production of transportation services. The cost of capital may be included either as a return on investment, as in (3) above, or as an average revenue need. The fourth method consists of substituting the average revenue need for the return on investment to reflect the cost of capital.

Average revenue need has been computed as the ratio of Freight Operating Revenue to Freight Operating Expenses, Rents and Taxes (excluding Federal Income Taxes). My Exhibit No. 36 (DMS-4) develops this ratio for the Eastern District and Southern Region for each of the three years 1960-62 and for the average of the three years. It also develops this ratio for the Pennsylvania Railroad and the Louisville and Nashville Railroad for the same periods. It should be noted that the ratios for the individual roads do not differ significantly from the territorial ratios for the region and districts to which they are assigned.

Average total operating cost for the ingot mold movement within Eastern District, based upon operating expenses, rents and taxes (excluding Federal Income Taxes) would be 355.8 cents per gross ton. This total operating cost increased to permit the recovery of Eastern District revenue need (7.0 percent) would be 380.7 cents per gross ton.

Average total operating cost for the ingot mold movement within Southern Region, based upon operating expenses, rents and taxes (excluding Federal Income Taxes) would be 148.4 cents per gross ton (using the method and operating factors of Witness Bowman). This average total operating cost increased to permit the recovery of the Southern Region revenue need (23.7 percent) would be 183.6 cents per gross ton.

The lowest sustainable Rail Full Cost, average total operating cost increased to reflect average revenue need, would be 364.3 cents per gross ton for the movement of ingot mold traffic. Barge Full Cost determined on this same basis, as introduced by Witness Rozaitis, was 355.5 cents per gross ton plus the additional consignee cost of 180 cents per gross ton, a total Full Cost by Barge of 535.5 cents.

III

Comments of Out-of-Pocket Costs Prepared by Rail Cost Witnesses

The out-of-pocket costs for the movement within Eastern District, Neville Island origin to the Cincinnati interchange are based upon: (1) average territorial factors for territorial costs, and, (2) system factors for the individual carrier cost for the Pennsylvania Railroad. Witness Javoronok does not indicate the system factors used in preparing the individual carrier costs. (Weights of train, empty return ratio of gondola cars, or switching minutes or cost).

Three comments are warranted from the cost data and statement submitted by Witness Javronok. Two relate to train weight factors and Group III (Remaining Running) cost, while the third concerns the consideration of switching at Pittsburgh.

First, Witness Javronok states that the use of Eastern District way train costs tend to overstate the line haul movement costs of the PC&Y, because the train weight of this Class II carrier would be increased to about 1700 ton including the competitive ingot mold traffic. The use of the heavier weight of way train, were it properly applicable, would have reduced the costs per carload by less than 15 cents or less than one-third of a cent per gross ton.

Second, Witness Javoronok used through train costs for movements in Trains PMC-3 (Pitcairn Yard Pittsburgh to Columbus) and Train CIN-1 (Columbus to Cincinnati). The use of through train costs would be justified only if the actual train characteristics approximate the through train, i.e.

Eastern District average weight of through train was 3,698 tons. The train weight and the other characteristics of the two trains were not introduced. The understatement from the use of through train costs could be many times the difference Witness Javoronok chose to call to the Commission's attention.

Third, Witness Javoronok fails to include any cost for the movement of the traffic between the interchange at Duffs Junction and start of the road train movement from Pitcairn Yard.

The out-of-pocket costs for the portion of the movement within Southern Region, Cincinnati interchange to the Green River Steel Plant spur at Steelton, Ky., were based upon: (1) territorial costs adjusted to reflect specific operating factors, and (2) Louisville and Nashville Railroad costs applied to these specific operating factors. The use of specific operating factors not based on special studies drastically reduce the costs for this segment of the movement without adequate factual support.

First, Witness Bowman's use of through train cost is not warranted from the description of the train movements between Cincinnati and Louisville (Train No. 75) and between Louisville and Owensboro (Train No. 158). Witness Bowman does not support his use of through train cost by introducing the average weight or consist of these trains. Witness Kirchner does not identify them as through trains, but does clearly indicate that these train crews perform a considerable amount of train switching at Louisville and between Louisville and Owensboro.

Second, Witness Bowman substantially reduced switching costs without adequate supporting data. Terminal road train to industry switching was reduced 78 percent, inter-intra-train switching was reduced 60 percent, and interchange switching was reduced 44 percent. The information furnished Witness Bowman by Witness Kirchner was neither consistent with, nor comparable to, switching factors developed by Rail Form A. It is highly improper to modify Rail Form

A unit costs and operating factors by broadly quantified judgment information. The testimony of Witness Westerfield indicates that empties moving eastbound are picked up by a westbound freight and carried to Doyle Yard. Such switching is not reflected by Witness Bowman. Further, Witness Bowman has included terminal freight car costs (Group VI) for only the loaded switching movement at destination (Bowman Exhibit, line 21), no car costs are included for an empty switching move.

Third, Witness Bowman has failed to include all of the terminal costs for destination (Group VIII costs have been omitted).

The out-of-pocket cost data prepared by the rail cost witnesses represent the lowest level of cost. The cost for movement in Eastern District represents the shortest route, while the cost for the movement, both switching and line haul, for Southern Region is grossly understated. For example, Witness Bowman reduced the out-of-pocket switching costs by 32.5 cents per gross ton based solely upon a possible operation described by an operating witness.

The rail out-of-pocket cost restated to correct for this unwarranted adjustment in switching costs would be 516 cents per gross ton, or 5 cents more than the proposed rate.

PROCEEDINGS

[5]

* * *

Mr. Ames: Mr. Examiner, there is a preliminary matter that I think we might settle at this time.

The parties have stipulated that the over-all costs for the barge-truck route are $5.11 per ton, which is exactly the same as the proposed rail rate. Mr. Leigh has stipulated that with me.

Mr. Leigh: I understand, Mr. Ames, that actually we were stipulating the truck expense from the transfer point at Owensboro out to Steelton. I have no objection to a stipulation such as you suggest, but my understanding is that the over-all cost is $5.15 instead of $5.11.

Mr. Ames: I think you are right. The barge rates are published and the only charges that could be uncertain are the transportation charge at Owensboro from barge-truck and [6] the trucking charge from Owensboro to Steelton. But there is an understanding that truck charges set forth in the protest are correct.

Exam. Dishman: Will you stipulate to that?

Mr. Leigh: Yes, sir.

Mr. Helmetag: Yes, sir.

* * *

[14] Q. (By Mr. Leigh) Would you please state your name and address? A. Joe C. Westerfield, 222 Brown Court, Owensboro, Kentucky.

Q. Mr. Westerfield, have you heretofore prepared for offering in this case and exchanged with Protestants a statement of facts? A. Yes, sir.

Mr. Leigh: Mr. Examiner, may we have the statement of Joe C. Westerfield marked for identification?

[15] Exam. Dishman: Respondent's Exhibit No. 3.

(Respondent's Exhibit No. 3, Witness Westerfield, was marked for identification.)

Mr. Leigh: Appended to Exhibit No. 3 is a diagram of the plant of the steel company presently marked Exhibit A. May we have that remarked?

Exam. Dishman: Respondent's Exhibit No. 4.

Respondent's Exhibit No. 4, Witness Westerfield, was marked for identification.)

Mr. Leigh: The next attachment is a photograph of the plant of the Green River Steel Company. May we have that marked?

Exam. Dishman: That will be Respondent's Exhibit No. 5.

(Respondent's Exhibit No. 5, Witness Westerfield, was marked for identification.)

By Mr. Leigh:

Q. Mr. Westerfield, since preparing your statement marked Exhibit No. 3, have you had an opportunity to make some closer investigation into whether you had any movement of ingot molds from Neville Island to your plant at Steelton by rail? A. Yes.

Q. And what was the result of your investigation? A. Do you mean what moved by rail?

Q. That is correct. A. I went back to 1962, and we showed two cars in 1962, and [16] 5 in 1963, and two cars as of March 26, 1964.

Exam. Dishman: At this point shouldn't there be a few changes in Exhibit No. 3?

Mr. Leigh: Yes, Mr. Examiner, I overlooked that. If we will look at page 2 of Exhibit No. 3 near the bottom of the page, there will be found references to Exhibits A and B, and the one exhibit A should be marked Exhibit No. 4, and where it shows Exhibit B should be Exhibit No. 5.

By Mr. Leigh:

Q. Mr. Westerfield, you make reference to the individual carloads taken during 1962, 1963 and 1964. Would you give us the weight of the lading in those single cars? A. These aren't accurate figures, they are in net tons, like two cars together. 112 net tons in 1962.

Mr. Ames: In each car?

The Witness: No, sir; that is the total of the two cars.

Mr. Helmetag: How much is it?

The Witness: 112 net tons.

By Mr. Leigh:

Q. Let's get it clear. On March 21, 1962 you had a shipment delivered to you in two rail cars, is that correct? A. That is true.

Q. And the total net weight was— A. 112 net tons.

Q. Now, would you proceed to give us the weights, the weight of the lading in the other single cars, and if they are not [17] single cars, indicate it. A. On January 30, 1963, one car, 60 net tons. February 14th, 2 cars, the combined weight, 106 net tons. April 22nd, 1 car, 63 net tons. On April 16th, 1 car, 47 net tons.

Q. Those were 1963? A. 1963. 1964, February 19th, we had one car, 67 net tons. On March 26th, one car, 49 tons.

Q. Mr. Westerfield, could you tell us what were the occasions for routing this by rail, these cars you have just mentioned? A. The occasion that brought this about occurs when you have a need for a different type mold than you already have, and you don't have time to wait for a combined barge or a big bunch of ingot molds. So if you are making a certain grade of steel, or a certain type, you would use a certain kind of ingot mold. And these were special orders for the occasion.

Q. Mr. Westerfield, you were furnished a copy of the testimony of Mr. Wesley Rogers to be presented here later by the Protestants. And included there was a tabulation showing the net tons of ingot mold moved by Waterways Freight Bureau members from Neville Island, Pennsylvania to Owesnboro, Kentucky. Did you check those tonnage figures provided by Mr. Rogers? A. I checked 1964, 1963, 1962, 1961 and 1960 barge shipments.

Q. Now, the figures you developed differed somewhat, did they not, from Mr. Rogers? A. Yes, sir; my figures show more tonnage shipped than Mr. Rogers.

Q. Would you just tell us the total for 1960 as you developed it? A. 1960, three barges, 1712 net tons.

Q. The same figure for 1961. A. Six barges, 3,878 net tons.

Q. And the figure for 1962. A. Six barges, 4,320 net tons.

Q. And for 1963? A. Seven barges, 5,017 net tons.

Q. And through March of 1964. A. Two barges, 1500 net tons.

Q. These are all net tons? A. Net tons.

Q. What has been your loss and damage experience, Mr. Westerfield, in the shipment of ingot molds? A. There has been no loss or damage occurred, no claims have ever been filed by us.

Q. Could you offer any explanation as to why that is so? A. Well, ingot molds are as a rule shipped in open-type barges or rail cars, they are stored outside, and there is very little damage that can come to them.

Q. Have you had occasion to observe the switching of railcars into [19] your plant? A. Yes, sir.

Q. Can you give the Commission an idea of the time, approximately, necessary for getting these cars off the L&N main line onto your siding? A. I would say it would take as an average 15 to 20 minutes to set off a cut of cars onto the siding that we have that is shown in Exhibit No. 4.

Q. Now, there has been no movement, has there, under these rates, obviously? A. No.

Q. But you have had occasion to observe multiple car cuts being set off at your plant, is that correct? A. It is very common to see 18 or 20 cars at one time of scrap iron and other material that we get.

Q. And you have personally observed these movements? A. Yes, sir.

Mr. Leigh: Mr. Examiner, the witness is now tendered for cross-examination.

CROSS-EXAMINATION

By Mr. Ames:

Q. Do you have the names of the barge lines which handled these shipments which you have read into the record? A. Yes, sir.

Q. Would you name them, please? A. 1960, two barges by the Ohio River Company, one by Mississippi [20] Valley.

1961, two by the Union Barge Line, two by the Mississippi Valley, one by the Ohio River Company, and there is a CB-303 barge, I believe that is Mississippi Valley, that would be another one for Mississippi Valley.

In 1962, Ohio River, two barges; the Union Barge Line two; Mississippi Valley, two.

1963, 5 Mississippi Valley Barge Line, one Union Barge Line, one Ohio River Company.

In 1964, one by Mississippi Valley Barge Line; one by Union Barge Line.

Q. When you receive a cut of 12 cars at your plant such as those you say you personally observed, are you able to take those cars into your plant all at one time? A. Yes, sir.

Q. And if they contain ingot molds you would make one spot inside your plant, wouldn't you, of the 12 cars? A. Well, one or two, probably two.

Q. And how many points of delivery do you have inside your plant for ingot molds? A. Well, we have ample storage, so that molds could be set off anywhere, since they are unloaded with a mobile crane.

Q. Now, when you receive a barge load consignment, how many trucks does it ordinarily require to bring that 750 tons into your plant? [21] A. To make the operation run smooth, it should run five trucks, a minimum of four.

Q. You mean they shuttle back and forth? A. Yes, sir.

Q. And how long does that take, generally? A. As a rule—I don't have the exact hours—I would say a day and a half.

Q. Is Neville Island your only source of supply at the present time? A. Yes, sir.

Q. What is the transit time for a barge movement from Neville Island to Owensboro? A. After the barge has been picked up by the tow, is that the question?

Q. Yes. A. Seven to eight days.

Q. And how long does it generally take at Neville Island to load the barge after it is spotted? A. I can't answer that.

Q. How long is generally required at Ownesboro to make the transfer of the tonnage? A. From a day to a day and a half.

Q. And what is the rail transit time from Neville Island to Steelton? A. I could only say approximately five to six days that is [22] including switching at the origin.

Q. On page 5 of your statement, sir, you say "If the proposed rate is approved and becomes effective, this company will allow the railroads to share in this business." Using the word "share" do you contemplate that you would divide this tonnage between the barge and the rail? A. Well, more or less. We haven't tried this yet.

Q. You haven't tried it yet? A. We haven't had a full train movement.

Q. In view of the difference in transit time and the difference in the unloading situation and delivery to your plant, what features of the barge service would induce you to pay them as much as you have to pay the rails for a much faster movement? A. Would you rephrase a little bit of that, sir.

Q. Do you want me to rephrase it or do you want him to read it? I will try to make it shorter. What would induce you to use a barge if you couldn't save any money in comparison with rail? A. Just past practice.

Q. You have never used a barge on a parity with rail up to this time, have you? A. We have always tried to keep at our mill equal transportation systems going, such as additional trucklines, they all share in the business.

Q. Let's ask you one more question about that. Can you point [23] out to me any specific siece of tonnage that you have received at your mill in the past where you have paid the barge line in combination with the truckline the same gross amount that you pay the railroads for the same traffic, can you give me one instance of that? A. No.

Q. So there hasn't been any traffic moving to your plant on a parity of rates as between barge and rail? A. No.

Q. But now you say there will be, is that your testimony? A. That is what I feel.

Q. What induces you to make that change? What is there about barge service that makes it attractive that you would pay the same amount that you pay the railroads for a much faster service? A. Well, this commodity isn't a matter of speed that we are speaking of. You are still buying in the same 600 gross ton lots.

Q. I understand you are. But you still have to take 750 tons for the barge load, and you still have the slow transit time. You say in spite of that you would pay the same rate to the barge company as you would pay to the rails? A. That is the way I felt at the time I made the statement.

Q. You have never done it before, though? A. No sir.

[24]

Q. Do you have one additional transfer of the cargo to make when you use the barge? A. We have the transfer at the Owensboro River Rail Terminal from the barge to the trucks.

Q. Are you familiar with the loading situation at Neville Island? A. No, sir.

Q. How long have you been with the company, Mr. Westerfield? A. Since 1953.

Q. Are you receiving any other traffic now by barge other than those ingot molds? A. No, sir.

Q. Have you in the past had occasion to ship billets from Steelton to Beaumont and Houston, Texas? A. Yes sir.

Q. And did you use the barge service for that movement? A. Yes, sir.

Q. The rail rates on billets from Steelton to Houston or Beaumont were reduced in October 1963, were they not? A. Yes, sir.

Q. And have you used the barge service since? A. No sir.

Q. At the present time there is a spread of $1.05 a ton, is there not, between the all-rail and the barge rate? A. Yes —you are speaking of the 600 gross ton rate?

[25]

Q. On the billets, I am speaking of. A. I think I can clarify this question why we aren't shipping billets by barge.

to Houston and Beaumont at the present time. Our tonnage —our sales in those areas have been reduced to approximately 400 to 450 tons. And when you figure your costs on that it's cheaper to ship by rail. So that is the way we ship. If we had more tonnage down there, more business, then we would ship by barge.

Q. If you could make the barge minimum? A. Yes, sir.

Mr. Ames: That is all I have, Mr. Examiner. Thank you.

Exam. Dishman: Is the barge minimum 600 gross tons?

The Witness: Yes, sir.

Exam. Dishman: What would that be in net tons? I believe Mr. Ames said something about 750.

Mr. Ames: 600 tons, Mr. Examiner. He is speaking of the Houston/Beaumont rate on billets.

The Witness: Yes, sir.

Mr. Ames: Not this ingot mold rate

To get the gross tons from net tons you multiply it by 112, and the other way around you divide it by 112. That is the conversion table.

Exam. Dishman: Now, what is the storage capacity of ingot molds at your plant? You store outside?

The Witness: Yes, sir.

[26] Exam. Dishman: Is it unlimited?

The Witness: You might say unlimited. For the amount we buy we have ample storage.

Exam. Dishman: Any other questions?

Mr. Helmetag: I just want to ask one question for clarification.

What is the minimum weight for the barge shipment of ingot mold from Neville Island to Owensboro, the barge minimum rate?

The Witness: Well, as I understand, they have 600, 500, 400, and possibly 3. I don't know if that is still in effect or not, I would say it is.

REDIRECT EXAMINATION

By: Mr. Leigh

Q. I would like to have a clear statement, Mr. Westerfield, of the operation at your plant when cars are delivered

to you. The question was asked you respecting the spotting of cars inside your plant. Do you use your own locomotives for taking these off the interchange and spotting them? A. Yes, all interplant switching is done by our own locomotives.

Mr. Leigh: I have no further questions.

Exam. Dishman: Do you offer the exhibits?

Mr. Leigh: Mr. Examiner, I would like to offer in evidence the exhibits marked for identification numbers 3, 4, and 5.

Exam. Dishman: Without objection they are received.

(Respondent's Exhibits No. 3, 4, and 5, were received in evidence.)

Exam. Dishman: And the witness is excused.

(Witness excused.)

* * *

[34] CHARLES D. BOWMAN

* * *

DIRECT EXAMINATION

BY MR. LEIGH:

* * *

[40] CROSS EXAMINATION

* * *

BY MR. AMES:

* * *

[42] Q. In preparing for this case did you give any consideration at all to fully distributed costs? A. I worked up the fully distributed costs, that is right.

Q. Now, taking as a starting point the out-of-pocket cost figure of 483-1/2 cents, how would you convert that to fully distributed cost, what would your answer be? A. As the cost under the so-called constant expenses.

Q. Could you give me a figure on that, how would you convert it.

Mr. Helmetag: Mr. Examiner, I object to this questioning. It is our position here that the fully distributed costs are completely irrelevant to the issues that are before the Commission in this case, that they have no relevance whatsoever, and that

any question with respect to what the fully distributed costs might be computed by one formula or another is irrelevant to the issue before the Commission in this proceeding.

Mr. Ames: I appreciate that is the railroad's position, but it is certainly not the barge line's position, and I don't [43] believe it is the Commission's position or the Court's position.

Exam. Dishman: Objection overruled.

The Witness: The fully distributed costs as developed through rail Form A, using the eastern district for the Pennsylvania Railroad portion of the haul and the southern region for the L&N portion of the haul, is 759.3 cents per gross ton.

By: Mr. Ames

Q. And that would be – if I wrote that opposite the 483-1/2 cent figures I would have the comparison between the out-of pocket and fully distributed? A. That is right. You want only the constant cost, is that what you asked for?

Q. I am asking for fully distributed cost. A. That, sir, is what I gave you, fully distributed cost.

Q. And that would be 483½ cents out-of-pocket and 795.3 cents fully distributed? A. Yes, sir.

Q. Now, your figures for your terminal study, as I understand you, Mr. Bowman, are not based on any time study, they are based on figures given you by Mr. Kirchner? A. That is correct, sir. Now, whether or not he made a time study is not up to me to say.

Q. I understand that. You did not make one? A. I did not make one.

[44] Mr. Leigh: You couldn't have, could you?

By: Mr. Ames

Q. That is right, you couldn't have, because you didn't have traffic.

One more question, Mr. Bowman. On page 2 of Exhibit 7, your statement, you make this statement: "While not

conceding that Form A costs are true costs or are a proper basis or method for ascertainment of the actual costs of transporting any specific commodity between any specific points, some indication of the compensatory nature of the proposed rates may be obtained by a comparison of the latter with such costs."

Now, if the Form A does not in your opinion give you a true cost figure, what kind of information would you have to have to make what you would regard as a true cost figure? A. Well, the only true basis of a true cost figure would be the actual study of the actual move from the specific point, in this case Neville Island, to Steelton, Kentucky.

Q. That would have to be an actual study of an actual movement, then? A. That is correct, sir. That would give you the only true cost.

* * *

[65] WESLEY A. ROGERS

* * *

DIRECT EXAMINATION

BY MR. AMES:

* * *

[68] CROSS-EXAMINATION

BY MR. HELMETAG:

* * *

Q. But you are not indicating that the traffic barge lines can compete with the railroads for the railroads are handling without competition, are you? A. Oh, they have competition, motor carrier competition and competition between themselves, naturally.

Q. And competition from the shippers who have the right to handle it in their own vehicles? A. Priority competition.

Q. And market competition, that is, competition of substitute commodities, for example, oil for coal, and that type of thing? A. Well, the railroads are probably handling the oil as well as the other commodities, It is difficult to say.

Q. But you are not intimating or inferring that because the railroads are not competing with the barge lines for certain traffic that the railroads are handling that traffic without competition, are you? A. No, I don't believe so, if I understand the question.

Q. Wouldn't you agree with me that in today's transportation market, based on your experience, you can characterize as one of persuasive competition in which there is competition throughout the country. [71] A. Very keen competition.

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[82] JOSEPH G. ROZAITIS

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DIRECT EXAMINATION

BY MR. AMES:

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[87]

Q. Do you know what the Barge Form C formula provides with respect to special studies as a basis for making an adjustment as to the time period for those special studies? A. No, sir; I think that is left completely open.

Q. Doesn't the formula indicate at some point that the time period for any adjustment shown relatively long? A. That may be.

I believe there is a footnote on one of these schedules that refers to that. However, I would like to point out that the time period here extends over a period of—well, for the year 1962 and 1963.

Q. We will come to that in a moment. Let me come back to that question.

We were talking about the explanatory statement with respect to Barge Form C. And if you refer to page 1 of Exhibit 24 where it says "Summary Schedule," isn't it true that the explanation of this formula indicates that the expenses are 100 per cent out-of-pocket? A. Yes, sir.

Q. And that the only difference between the barge out-of-pocket costs computed by this formula and the barge fully

distributed is that with respect to the fully distributed costs there is an allowance for return on investment or an allowance for profit based on the operating ration of the [88] carriers? A. Well, I wouldn't put it quite that way. I would characterize it as saying that the cost before any application of a return on investment or application of an operating ratio would be more properly termed full barge costs. There is no element of out-of-pocket costs, because as you indicated before, these costs are considered to be 100 per cent variable.

Q. Now, the statement that specifically refers to that is found on page 1 under the heading "Summary Schedule" where it reads, "In the absence of studies showing the actual proportion which out-of-pocket expenses are total barge expenses, the operating expenses are treated in this formula in effect as though they were 100 per cent out-of-pocket." A. That is right.

Q. And then it goes on to say "The expenses including interest expense represent an average level which must be exceeded in order to realize profit." That is what it says, isn't it? A. Yes.

Q. The only difference between the out-of-pocket costs computed by Barge Form C and the fully distributed cost is that the fully distributed costs include an allowance for profit or for return on investment? A. No, sir; I would not accept the connotation of out-of-pocket costs, because there have been no studies made to show exactly at what point these costs do vary. We say we are [89] simply treating them as though they are 100 percent. I will not concede that they are 100 per cent.

Q. Whether you concede it or not, the formula treats them as if they were all 100 per cent out-of-pocket? A. Yes, if you want to use the term "out-of-pocket." Personally I don't believe that is the proper use of the term itself.

Q. You would rather call them variable or incremental costs? A. I would call them total expenses.

Q. That vary with the traffic? A. I didn't introduce the word "variable," I would say the total expenses.

Q. Now, the Rail Form A out-of-pocket or variable costs they include return "on investment," don't they? A. Yes, I believe they do.

Q. So that so far as a comparison of the two formulae are concerned, the rail out-of-pocket includes items of expense which would be referred to as fully distributed in the Barge Form C, isn't that right? A. To a certain degree, I believe it is 80 per cent.

Q But I am talking about the return on investment, that is treated as a constant or a fully distributed cost under the barge formula, but under the rail formula it is treated as a variable or out-of-pocket expense, isn't that right? A. I don't know, I don't know exactly how it is treated by Rail From A, whether the equipment is treated as 100 per [90] cent out-of-pocket, and the road 50 per cent.

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[135] DELBERT M. STEINER

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DIRECT EXAMINATION

BY MR. AMES:

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[136]

Q. All right, Mr. Steiner. A. I would like to explain a little bit of the rationale to my conclusions in Exhibit 32.

[137] The mere fact that a rate exceeds "out-of-pocket" cost does not impute to that rate a condition of compensativeness. However, any rate which fails to fully recover a reasonable "out-of-pocket" cost imposes a financial burden upon other traffic, causing other traffic to subsidize that on which the rates fail to recover out-of-pocket cost. Similarly, rates providing a relatively low unit revenue contribution also impose a financial burden on other traffic unless the rates generate a sufficiently large volume that the increased volume actually tends to reduce the average unit revenue contribution necessary from other traffic. Differential pricing will tend to maximize revenue contribution only if the increasing volume of traffic tends to reduce the average unit revenue contribution.

When two carriers of the same method of transportation (carriers having similar, if not the same, cost characteristics), compete for a given movement of traffic, a reduction in rate purely to divert the movement from the other is economically unsound unless the lower rate generates at least a proportional increase in volume. When each of the carriers have the same cost structure each has an equal opportunity to retaliate. Conceivably, each could reduce its rate to an "out-of-pocket" cost level, but not without impairing their net revenue. Such rate reductions can result in only short-term gains since neither could continue to offer the service over a prolonged period unless the increases in volume were at [138] least as great as the reduction in rate.

If one of these carriers were larger than the other, the larger carrier could sustain the loss over a longer period of time in order to force the smaller carrier to forego the competitive traffic. Even here the larger carrier could not continue the service at the lower rate indefinitely without increasing rates on the remaining traffic, or accepting the lower net earning.

When two carriers having significantly different cost characteristics compete for a given movement of traffic, a reduction in rate purely to divert the movement from the other is economically unsound unless: (1) the lower rate tends to increase the total volume of this competitive movement; or (2) the lower rate results in a more economic allocation of resources.

Since the reduced rail rate is no lower than the existing barge rate it is not reasonable to suppose that it will have any effect on the total movement of ingot mold from Neville Island to Steelton.

There is no indication, based on this record, the movement of the ingot mold by rail will result in a more economic allocation of resources.

Determination of inherently lower cost between two methods of transport requires the consideration of all elements of cost which will be affected by the rates charged by each of the [139] two methods of transporta-

tion. Cost characteristics of rail and barge carrier differ widely, but they have one thing in common: Their revenues must fully recover the cost of operation and the cost of capital if they are to provide a sustainable transportation service, both now and in the future.

Relative size of carrier and the degree of variability of cost are unreasonable and unsound economic criteria on which to determine the inherently low cost. Both represent short-term advantages which cannot be sustained indefinitely. The larger carrier has a greater ability to sustain short-term losses over a longer period of time, an advantage it cannot perpetuate without impairing its ability to continuously provide the transportation service.

Similarly, the carrier with the lower degree of variability, or greater proportion of constant cost, has a short-term advantage which cannot be sustained indefinitely. The apparent advantage is artificial. If the relatively larger constant cost results from either lack of utilization or from internal dis-economies of operation, the exclusion of constant costs places a premium on past investment or perpetuation of operating dis-economies.

Neither relative size nor degree of variability of costs are valid economic criteria for the allocation of resources.

The valid economic basis upon which to determine inherently low cost advantage is long-term total cost or full cost.

[152-153]

* * *

Q. Would you turn, please, to page 6 of your prepared statement.

Do I understand that table in the middle of the page to be 8 different methods of allocating constant costs? A. Yes, sir.

Q. Can you tell which of this list of 8 would be the proper one to use? A. I think you have to consider all possible methods.

Q. And this means there are 8, at least you have listed 8, and there are probably 800 different ways to allocate con-

stant costs, is that right? A. There is an infinite number of ways.

Q. Would you look at page 8 of the prepared statement, please. [154] In the second paragraph there I notice you have used the expression "national resources"? A. Yes, sir.

Q. Could you briefly define what you mean by "national resources." A. "National resources" are those physical resources of the country.

Q. You are here talking about the United States, I take it? A. Yes. This would be in manpower and in natural raw materials, and so forth.

Q. On page 9, Mr. Steiner, I find this statement: "The average total barge cost of 519.7 cents per gross ton is directly comparable to the average total cost of 687.9 cents per gross ton." I will ask you, this figure for the barge costs, does it include any kind of deficit figures, such as those for the passenger business. A. It would, if they had such-

Q. I am not asking you if, but does it? A. Not to my knowledge.

Q. Does it include any deficit for less-than-carload traffic? A. It wouldn't include that unless the carrier had a less-than-carload deficit.

Q. I am talking about this figure that you put in here. A. I do not know whether they have a less-than-carload business.

Mr. Ames: We will concede that it don't.

Mr. Leigh: Very well. Thank you.

[155] Q. Is there anything in this gross ton cost figure, anything in it at all comparable with roadway expense or investment. A. To the extent that they have to pay it.

Q. And what is that extent? A. I didn't compute their costs, so I am not familiar with what they put in. I am accepting his, I have accepted Mr. Rozaitis' costs as he developed them.

Q. Mr. Steiner, I am not arguing with you, but you have made a pat statement here that these two figures are directly comparable, and I want to know the basis for that remark.

A. They were computed upon the basis, as I have explained in the statement, of the total operating expenses, rents and taxes, and a four per cent return on investment.

Q. Now, is there anything in there comparable – you say it is directly comparable – A. The method is directly comparable–

Q. –with the rails. I want to know what proportion of this barge cost is comparable to the road investment of a railroad.

Mr. Ames: I submit that he should have asked Mr. Rozaitis that question.

Mr. Leigh: I submit that this witness is using figures and drawing conclusions from them and putting statements in this record that are not accurate, and all I am trying to do is get at the bottom of it. And I think I am entitled to [156] ask this witness about figures he has chosen to use.

Mr. Ames: I submit that he should have asked the question of Mr. Rozaitis.

Exam. Dishman: You stated, did you not Mr. Witness, that you simply accepted Mr. Rozaitis' figure as he developed it?

The Witness: Yes, sir; as representing the total operating expense, rents and taxes, plus four per cent return as developed in the barge Form C from the reports to the Interstate Commerce Commission with such special studies as were necessary to complete the form.

Mr. Leigh: Mr. Examiner, I submit that this is an expert witness. Now, he has chosen to use a certain figure and make representations to this Commission about directness of comparability, and he knows perfectly well the answers to my questions.

Exam. Dishman: What was your question now?

By Mr. Leigh

Q. The question was this. Speaking of comparability, what does the barge cost figure you have cited here include that is anything like the equivalent of a railroad investment in its roadway.

Exam. Dishman: Do you know?

The Witness: Well, obviously a barge cost can't operate on a roadway, it operates on a waterway.

By Mr. Leigh:

Q. So there is no comparability, is that right? [157] A. The method is the comparability – I have said that this is a comparable method, if it is not clear, then I should make it clear that the method in computing the two are comparable.

Q. There is no roadway for the barge lines, and yet there is something to compare with the railroad's costs?

Mr. Ames: That has to do with the constituency of the figures, Mr. Examiner, that has nothing to do with –

Mr. Leigh: Mr. Examiner, I much prefer listening to the witness.

Mr. Ames: Well, I have a right to see that the question is clear and that it is proper.

Exam. Dishman: Is there anything more that you can say about that? You are talking about methods rather than identical figures?

The Witness: Yes, sir.

Mr. Leigh: And I am talking about methods too, Mr. Examiner. Obviously the figures are not the same.

Very well.

By Mr. Leigh

Q. Now, would you tell us what investments the barges have in the waterways. I will cite you your statement on page 9 in which you say this: "Rail full costs must include provisions for recovering operating costs as well as the cost of capital dedicated to the production of transportation services." Now, I am asking you, what investment do the barge lines have in the waterways over which they operate? [158] A. Specifically I do not know.

Q. Do they have any? A. To the extent that they have any expense over which they have control, then they would have.

Q. All right, supposing you tell us about these expenses. A. These expenses are listed in the annual reports of the barge lines.

Q. Do they go out and build locks and dams to let them up and down a river, for instance? A. No, sir; those are built by Congress.

Q. Is the answer to my question that the barges have no investment in the waterways? A. I don't know that they have no investment, but I know that they don't have a complete investment.

Q. If there is any at all it would be infinitesimal, wouldn't it be? A. As I understand it, they have facilities at their port sides and certain things like that. I don't know the extent of their investment in that.

Q. Do you know to what extent the Government takes care of those port facilities? A. No, sir.

Q. Let's put it very simple. Does any barge line you represent own any of the Ohio River, for instance? A. As a citizen of the United States, I would think that they [159] would.

Q. That is a very intelligent answer.

Mr. Steiner, could you inform us at this time how much money the United States has invested in the Ohio River as a waterway?

Mr. Ames: I object to it, Mr. Examiner.

Mr. Leigh: I asked him if he could do it, he can say yes or no.

The Witness: The answer is no.

By Mr. Leigh

Q. You wouldn't be concerned about that?

Mr. Ames: I have got the answer, let's not have the comment.

Mr. Leigh: All right, then, I will ask the question.

By Mr. Leigh:

Q. You wouldn't be concerned with the investment of the Government in the Ohio River as a waterway, would you? A. No, sir. It is not an expense of the barge lines to be recovered from these particular rates.

Mr. Leigh: I have no further questions. Thank you, Mr. Steiner.

CROSS-EXAMINATION

By Mr. Helmetag

Q. Mr. Steiner, I have just a few questions. Will you turn to page 1 of Exhibit 32. You state in your qualifications that you are a transportation economist. When you were asked to prepare your testimony in this case were [160] you asked to make representations to the Commission as an economist or as a cost analyst? A. I think one particular element of economics is cost. Cost analysis is as much a part of economics as the theory of macroeconomics or micro-economics – you can get into hundreds of fields. All of them are in the field of economics.

Q. Mr. Examiner, I think my question is a simple question. My question is, what type of representations was he asked to make to the Commission, was he asked to make representations as a cost analysis or as an economist? Now, that calls for a fairly simple answer, not a long discussion. I think we will get along much faster if we get answers to the questions. I don't like to quarrel about this. But that wasn't an answer to the question.

Just tell us, what were you asked to do? Were you asked to make a presentation to the Commission as an economist or as a cost analyst, which? A. I refer to myself as an economist. And when somebody approaches me, this is the type of service that I give.

Q. Do you regard the testimony that you have submitted which has been designated Exhibit 32, do you regard that as a statement of economic principles or as a statement related to the costs of these particular services? A. This predominantly relates to the examination of the cost data submitted by the railroads and the application of the [161] development of the constant costs for these particular operations.

Q. In the first paragraph you state that you have done some study in economics. What kind of economic study did you engage in? A. I have done micro-economics and macro-economics studies.

Q. The courses that you took in American University, what type of economic studies were those? A. They included

the theory of economics, econometrics, mathematical economics, there were two courses involving economic history and economic theory which were similar courses.

Q. Have you ever written anything in the field of economics as contrasted with the field of cost analysis? A. Yes, sir.

Q. Could you tell us – could you give us a list or furnish us with a list of those economic writings of yours, not necessarily now, but before the case concludes? A. Well, the preparation of material for the Post Office Department on the pricing of postal services.

Q. That is a Government monopoly service, isn't it sir? A. Yes, sir.

Q. Have you ever had any writing in the field of competitive economic pricing? A. Yes, sir.

[162] Q. They are the type of things that we would like to see. Would you give us a list of those publications? A. I prepared a paper for the American Society of Traffic and Transportation, I don't recall the precise title, but it dealt with determination of prices in a competitive situation between motor carriers and railroads.

I have also had a publication which has been published by the Practitioners Journal of the Interstate Commerce– the ICC Practitioners Journal which is entitled, "The Elasticity of Demand for Transportation."

Q. Now, on the second page of Exhibit 32 for identification you refer to the fact that you were employed as a transportation cost analyst with the Cost Finding Section of the Commission from 1946 to 1950. At the time that you were employed by the Commission did you do any work on the document which is now known as The Explanation of Rail Cost Finding Procedures and Principles Relating to the Use of Costs, which is Statement No. 7-63, the current version of it, did you do any work on that? A. Not on the current version.

Q. I mean with the– A. On the original material I helped prepare various portions of it.

tions of it.

Q. And did you work with Dr. Edwards at the time this statement and the cost formula known as Rail Cost Form A were being developed? [163] A. Yes, sir.

Q. At the time that you were with the Commission was any work being done on the so-called Barge Form C formula? A. No, sir.

Q. I have before me the current explanation statement, which is Statement No. 7-63. There were several earlier versions of this. I am referring to page 3 of this statement, referring to out-of-pocket costs, it makes this statement: "Whatever the term used, the figures have reality in rate-making only to the extent that they reflect added costs which were incurred because the traffic in question was handled or the costs which could have been avoided if the traffic were not handled." Did you participate in the preparation of that explanation of out-of-pocket cost as computed in Rail Form A, did you have anything to do with that statement? A. You couldn't pinpoint any particular statement in that book and attribute it to anything that I may have contributed to that. I was in the section at the time, and I sat in on discussions when these were developed, and there may be a word that I inserted or there may not have been

Q. Would you agree with that statement as being a sound representation of what is developed by the Rail Form A cost study? A. I would say that was the objective that they were attempting to achieve.

Q. That the Rail Form A so-called out-of-pocket costs develop [164] what in the economic field are known as incremental costs? A. I would not say incremental costs, because this has a rather special connotation among the economists.

Q. But the attempt in Rail Form A is to develop the costs of handling the added traffic, isn't that right? A. Again, transportation is so cluttered up with terms describing particular levels that I think the Commission did wise in adopting the term "out-of-pocket" which had not been given a large useage up until that time.

Q. Are you familiar with the statement on page 5 of this explanation which says that "The costs which are found to vary in direct proportion to out-of-pocket are designated in the cost studies as out-of-pocket," do you agree with that? A. Yes, sir.

Q. Then the reference to out-of-pocket costs in the Rail Form A study is to the costs which vary with the traffic, isn't that right? A. You have to take one step between what you have said and Rail Form A.

Q. What is the one step? A. And that one step is that you have assumed that 80 per cent of the expenses are variable, operating expenses, rents and taxes are variable, and that 50 per cent of the investment on road would be variable.

[165] But the formula – I am just trying to say what the formula attempts to do – the formula attempts to compute so-called out-of-pocket or variable costs, the costs which would vary with the traffic, the added units of traffic. A. That is the objective of the formula.

Q. Now, did you have anything to do with the Commission's explanation of the fully distributed costs or the cost sections explanation of fully distributed costs? A. All I can say is that I sat in on sections when it was discussed, and I read it, and at times gave comments. I couldn't tell you whether anything that I said was accepted or included.

Q. On page 24 of the current statement, Statement No. 7-63, which is in substantially the same as the earlier explanation, in referring to the constant cost it makes this statement: "These expenses remain unchanged, irrespective of whether or not particular shipments or classes of traffic are handled. In effect they are incurred on behalf of the operation as a whole. They can be only avoided by the abandonment of the entire operation, or at least a very substantial portion of it." And it goes on to say, "While such costs are obviously directly assignable to the carrier's operation taken in their entirety, they are not assignable on a cost of service basis to any particular shipment or class of traffic."

Do you agree with that explanation of the constant costs? [166] You can't ascribe them on the basis of the cost of service.

Q. To any particular type of unit of traffic? A. That is right.

Q. If they have any relation or any relevance, they relate to the operation taken as a whole, is that right, the constant costs? A. No. You are going beyond the statement there, I believe. These are costs that must be recovered in order to make the carrier whole.

Q. Will you tell us, then, what this statement of the cost section which is found on page 25 of the explanation means, which reads, referring again to fully distributed costs. "More important, however, their particular function is to provide a yardstick of what must be recouped in the long run from the operation as a whole, and so serve to measure the long-run compensatory character, not of a particular rate, but of the rate structure as a whole." What does that statement intend to imply in view of what was said before? A. I would interpret that to mean that when you are measuring the compensatory nature of a particular rate in the context of a rail operation – and you might say that this is in the context of a monopolistic competition – that you are attempting to maximize rail net revenue, holding all other elements constant, including competition. But you can't stop there. [167] You must at some point determine that the firm or the railroad or the group of railroads must come out whole.

Q. Doesn't this statement in effect say that the fully distributed costs have no relevance to determining whether a particular rate is compensatory, that they only have relevance when you are looking at the entire rate structure of the railroad to determine whether taken as a whole it will produce enough revenue to cover not only the variable costs of the moving of the traffic, but also the constant cost isn't that what the statement says? A. I think that would be a very narrow interpretation of it. There are many areas in which the allocation of constant cost or the determination

of the revenue need is a very important consideration in the determination of rates.

Q. In this particular litigation which is before the Commission we are not dealing, are we, with the rate structure as a whole of the railroads? Would you agree with that? A. You are not dealing with the rate structure as a whole, no, sir.

Q. We are dealing with a single commodity rate between two points, isn't that right? A. Yes, sir.

Q. Now, wouldn't you think that the rate that is before the Commission in this litigation is of the type in the statement I read to you, which is referred to as a particular rate? [168] A. I don't know if the reference which you are using "particular rate" relates into the statement that you have read but you would also have to add to it "all other things being held constant."

Q. We are dealing with a specific rate here, aren't we? A. A specific rate. And if you are going to measure its compensatory nature in this way, you must say that it is in isolation from all other factors.

Q. And according to this explanation of the cost section to determine the compensatory character of this particular or specific rate, you look to the out-of-pocket cost and not to the fully distributed cost, isn't that what the statement says? A. When you are looking at it in isolation of all other factors.

Q. But when you are looking at it to determine whether it is compensatory, which is what we are dealing with in the question I am asking, that is what you look to, the out-of-pocket costs, isn't that right, isn't that what the statement says? A. Well, I have not fully read the statement recently. But I could say that that is what the statement says.

Q. You don't disagree that that is what it says, do you? A. Well, I would have to read it carefully to make sure. I don't have it in front of me.

[169] Q. You spoke of the fact that you had dealt with a subject which is known as the elasticity of demand. This explanation which I have been referring to on page 26

makes this statement: "The apportionment of the constant and joint costs is fundamentally based on a weighing of the effect which the rates themselves would have upon the movement of the traffic and the carriers' revenues. Of far reaching significance in this latter connection has been recognition and the application of the principle that by reducing the rates on traffic, having expansible (elastic) traffic volume the contribution to the constant costs or revenue needs can be increased within limits beyond that attainable by limiting rate differentiation strictly to cost of service contributions."

Doesn't that say to you that the fully distributed costs have relevance primarily in the area of the elasticity of demand? A. Could I have that question read, just the last portion of it?

(The pending question was read by the reporter.)

The Witness: The question is, do the constant costs only have a relevance in the areas of elastic demand?

By Mr. Helmetag

Q. Elasticity of demand? A. Elasticity of demand. Not only.

Q. Not only. A. Predominantly, but not only.

[170] Q. Let me ask you a question, coming to this specific rate which is involved here. The record here shows that the railroads are not handling any of this traffic, that is, the volume traffic.

Mr. Ames: I object, Mr. Examiner. That is completely contrary to the record.

Mr. Helmetag: Let me put it this way. I am simplifying it.

By Mr. Helmetag

Q. The record showed and the barge witnesses testified yesterday to the effect that the barge lines are handling the overwhelming preponderance of this traffic, that the railroads have only handled a very few cars in emergency or special situations. Now, the evidence also showed that if this rate becomes effective, the railroads will divert from the barge lines a substantial portion if not all of the traffic that the barge lines are presently handling. The record also shows

that the rail rate will produce revenue in excess of the out-of-pocket costs as computed by Rail Form A. Now, I ask you whether the railroads will not be better off with this rate in effect than they are without it, or they would be without it? A. This would be a matter of the facts, that would have to be developed.

Q. Assume with me that the facts are as I stated, I ask you whether the railroads will be better off with this rate than without it? [171] A. You would have to go through the computation to make that determination.

Q. I am asking you to assume with me that the facts as I stated them, you don't have to make any computation to go through that situation. A. Well, the magnitude of each one of the facts you gave has a very important bearing upon the end results.

Q. You can't answer that question making the assumption that I made, you can't answer that question, sir? A. If you assume – this is the assumption that you are making, as I understand it – if one assumes, if you assume that the railroads are moving a small portion of the traffic now moving, the barge lines are moving the preponderance of it, with the change in rate the barge lines will move none, the railroads will move all. On the assumption that this added traffic will, merely by the fact that it covers out-of-pocket cost, adds to the rail net revenue or contribution, whatever you call it, cannot be determined by the facts you have given me without adding in the rates and actually making a computation as to what the effect would be in this situation. The facts are all there, it is just a case of making computations.

Q. Now, will you assume with me that this rate will produce revenues that will exceed the out-of-pocket costs by 40 cents a ton, just assume that it will show that. Now, would you agree with me that if this rate will attract to the [172] railroads a substantial part of all of the traffic that the barge lines are presently handling, that the railroads would be better off with this rate than they would be without it, can you answer that question, sir? A. You would

still have to find what they are getting from the present movement that they have, and how small it is, as compared with the potential movement.

Q. The evidence shows that they are getting about two carloads a year of the present traffic.

Mr Ames: The record doesn't show anything of the kind.

Mr. Helmetag: How much does it show?

Mr. Ames: Eight cars.

By Mr. Helmetag

Q. Eight cars a year under the present rates – and that this traffic is moving in a solid barge load almost per month. Now, would you say that the railroads would be better off under this situation. A. There would still have to be a computation made.

Q. Did you make any such computation? A. I haven't made such a computation as yet.

Q. You are not in a position, then, to state what the railroad situation will be as to whether there will be any contribution to the railroads net or to the burden as a result of this proposed rate. A. Well, if your question is merely to whether or not this rate would contribute to the overhead burden, to the extent [173] that it covers the Rail Form A cost it would contribute to the burden which is in excess of the Rail Form A cost level.

Q. And if it doesn't on a substantial number of units of traffic the railroads will be better off with it, won't they, sir? Doesn't it follow by definition? This isn't hard, is it? A. If you are assuming that this could do it, it is possible that they could do it.

Q. You don't have any doubt that it will, do you? A. Yes.

Q. You seriously have doubts that this rate is not going to make a contribution to the railroad's net, do you have a doubt as to that in view of what you heard yesterday? A. I have a doubt that it will make a greater contribution than the present traffic.

Q. You studied this proposition and listened to the evidence yesterday, and make that statement, sir? A. Yes, sir.

Q. I want to refer you to page 4 of your testimony. You make what appeared to be a criticism of the rail cost analyst when you say "Neither rail cost witness drew any conclusions as to whether the extremely narrow margin between the proposed rate and the out-of-pocket costs was an adequate contribution to rail constant costs for either carload traffic generally, for ingot mold traffic as a whole, or traffic moving between [174] Pittsburgh and the Owensboro area, or for the specific traffic here under investigation." Do you regard it as a function of the cost analyst to determine what a rate or what a price should contribute to the constant expenses of a carrier, is that the function of the cost analyst? A. The function of the cost analyst is not necessarily to determine how much, but he should determine whether it is adequate or not.

Q. Isn't it the function of the pricer of the service to determine how much contribution a particular price will make to the constant costs of the individual carrier? A. If he is fully aware of what the needs are; yes, sir.

Q. And isn't the contribution that will be made by any price to the constant expense of the company determined by the number of units that the price will generate, and the amount that the price will exceed the out-of-pocket costs of producing the service, isn't that the consideration? A. This is the basic consideration, it is the revenue contribution above the out-of-pocket level times the volume that gives you the gross consideration.

Q. And that is the judgment of the pricer, isn't it, sir, not the cost analyst? A. The cost analyst has to tell him what his revenue need is that he ultimately has to cover.

Q. It is not covered by any particular rate, but by the rate [175] structure as a whole? A. As a whole, and various segments of it can be measured as part of that whole.

Q. Now, sir, in the next paragraph on page 4 you say, "It is obvious that no carrier or group of carriers could operate for very long under a rate structure that merely approximates marginal (out-of-pocket) costs." You are talking about the overall rate structure there not a parti-

cular rate, isn't that so? A. Well, it becomes one of how many rates are at this level, the more rates you get at this level, the greater your volume has to be if you are going to actually cover your revenue needs.

Q. You didn't mean to indicate that any rate that would be below the fully distributed cost level would be unlawful or an improper rate, did you? A. I wouldn't want to commit myself on what lawful is.

Q. Would you say it was unsound or unreasonable from an economic standpoint? A. If it is an isolated exception it would not be unsound. If it is a general rule or becomes a general rule, then it becomes a different matter. It is the number of rates that are at this level that ultimately determines whether or not the carrier meets his revenue need.

Q. And isn't it in the nature of things that some of the rates would be above the fully distributed cost level and some would [176] be below the level, isn't that inherent in the statement you just made? A. Yes, sir; it changes continuously.

Q. And did you determine whether the rate is lawful or reasonable – leave out the word "lawful" – did you determine whether it is reasonable or economically sound as to whether it is below or above the fully distributed cost level, in view of what you said? A. You have two additional considerations to that which you have mentioned, as to just whether it is above or below. And that is as to whether or not this elasticity of demand to which you referred before is being fully – I hate to use the word "exploited" but I am using it in an economic sense and not in the sense of exploiting somebody just for the economic gain over them.

Q. The present barge rate that the carriers that you are representing are maintaining, it doesn't cover the barges fully distributed costs, are you aware of that? A. I don't know that I am specifically familiar with the rate itself and the comparison, I have also used it in conjunction with the added shipper expenses.

Q. Would you assume with me that it does not cover the barges fully distributed cost, would you say that it is an economically unsound rate for that reason? A. It is neither economically unsound or sound merely because [177] it covers out-of-pocket costs.

Q. It has been in effect for several years, and it has attracted a lot of traffic to these barge lines. Would it appear to you that it is economically sound in view of that? A. Well, when you say a lot of traffic, when you say 7 barge loads a year, I don't know whether this is a lot of traffic or not.

Q. If it has attracted all that is available or substantially all that is available, would you say that it is an economically sound price? A. It could be.

Q. Now, this rate which the barges are maintaining makes a smaller contribution to the barges fully distributed costs than the proposed rail rate will make to their fully distributed costs, will you assume that with me for the moment? A. Assuming that it does, you say?

Q. Yes. A. All right, I will assume that it does.

Q. Assume that with me. Now, would you say that in view of those circumstances the rail rate is economically unsound, the proposed rail rate? A. Do you want me to assume a situation where the margin above out-of-pocket cost of the barge rate is less than the margin above out-of-pocket cost of the rail rates?

Q. I want to ask, in view of that assumption – [178] A. That is assuming that both of them have the same revenue need or the same average, each making the same proportional contribution to constant cost.

Q. I am asking you, on the basis of that assumption alone whether you can say that the rail rate is economically unsound? A. You would have to add one more assumption to it before you could make –

Q. Just on the basis of my assumption, what would you say? A. On the basis of your assumption I would say that I could not draw a conclusion, because I would have to know the relative revenue need per unit of traffic of the two modes of transportation.

* * *

Q. Let me refresh your recollection on it. That figure is [179] made up of the barge fully distributed costs computed by using Barge Form C. Added to that is the shipper's expenses in moving the traffic across the dock at Owensboro, plus the shipper's expense in moving the traffic by truck from the dock at Owensboro to Steelton. Now, would you agree with me in view of what I have said that that figure of 519.7 cents isn't even a cost figure? A. It would be the cost of barge service to the shipper – it would be the barge cost plus the shipper's cost of getting it from the barge to his location.

Mr. Ames: Mr. Examiner, I believe I could save time there by concession . The barge rate, the tariff rate of the barge line, as I said yesterday, is a published rate, and we have backed that up with a cost study. On the ancillary services, so to speak, the unloading of the barge to a truck, and the truck movements to Steelton, we are assigning the cost to that movement on a pay-out basis. There is no attempt to conceal that fact at all, we believe that that is proper, and we believe it overstates costs, but we will not argue that.

Mr. Helmetag: We are not quarelling with that.

Mr. Ames: It is not a cost study, it is an ancillary service.

By Mr. Helmetag

Q. I am asking the witness is how you can say the two figures are directly comparable when one is made [180] up partly of costs and partly of charges to the shipper –

Mr. Ames: That is a matter of argument.

By Mr. Helmetag

Q. I am asking the witness how he can say that they are directly comparable? A. I am referring primarily there to the method by which the barge and the rail costs were computed. To get them from the same point to the same point they had to add to the barge costs this additional element to represent the additional expense incurred by the shipper or the receiver to obtain it at his location.

Q. Does it strike you as illogical or some sort of strange reasoning to say that two things are comparable when one of them is made up of costs and the other item is partly based on prices? Costs and prices aren't comparable, are they, or directly comparable.

Mr. Ames: I object, Mr. Examiner. This is pure argument.

Mr. Helmetag: It isn't argument.

Mr. Ames: I have told you very frankly that the ancillary costs are added to our barge costs on a pay-out basis. Now, we can talk about it forever, we can get into semantics, but that is it. What is the use of arguing about it?

Mr. Helmetag: It is like comparing oranges and pineapples.

Mr. Ames: I don't agree with that at all.

Mr. Helmetag: He is an expert.

Exam. Dishman: I think the record is clear just what was [181] taken into consideration in arriving at these figures.

You can't say anything more about it, Mr. Witness, than what you have already said?

The Witness: That is right.

By Mr. Helmetag

Q. Let me ask you, sir, did you have occasion to review the statements that I circulated last night of Dr. Baumol, Buchanan and Dr. Heflebower? A. I read them through.

Q. Are you familiar with any of the authors of those statements as economists? A. Only by their reputations.

Q. They have recognized standing in the economic field do they not sir? A. Well, there are quite a few –

Mr. Ames: What good is it if he says yes or no?

Mr. Helmetag: I am going to ask him if he agrees with them.

Mr. Ames: That doesn't make any difference, Mr. Examiner.

Exam. Dishman: What is the purpose of this questioning, Mr. Helmetag?

Mr. Helmetag: We are dealing here in this litigation with the economic principle to be followed by the Commission

in determining competitive adjustments. And I am glad the Examiner asked me about the relevance of this, because it goes to the very heart of this litigation.

The National Transportation Policy requires the Commission [182] in these inter-mode situations to recognize and preserve and foster sound economics in transportation. We are here trying to bring to the attention of the Commission the proper and sound economic principles to be utilized in judging the lawfulness and reasonableness of reducing rates of this type, and the only concern about their lawfulness is the impact on a competitor of a different mode. And it is to that problem that my questions are going. And I ask this witness to state as an economist – and also as to that problem we are presenting the testimony of several economists to show what are the sound economic principles to be followed in these competitive pricing situations.

Mr. Ames: I assume that that will all be treated as so much considering in the consideration of the case. But I still say, what difference does it make whether Mr. Steiner thinks Dr. Baumol is an Expert.

Mr. Helmetag: I won't pursue the question.

Mr. Ames: What do we get by that?

Mr. Helmetag: I have no further questions.

Mr. Ames: I have a few, Mr. Examiner, if you want to declare a recess.

Mr. Helmetag: Before we go, Mr. Examiner, I have a problem – maybe I could ask Mr. Ames about it.

Exam. Dishman: Off the record.

(Discussion off the record.)

[183] (Whereupon, a short recess was taken.)

Exam. Dishman: The hearing will come to order, gentlemen.

Mr. Helmetag: Mr. Examiner, before the recess the Witness Steiner was temporarily removed from the stand in order to permit Dr. Baumol to testify.

WILLIAM J. BAUMOL

was duly sworn and testified as follows:

Mr. Helmetag: Mr. Examiner, yesterday at the close of the hearing we circulated the statement of William J. Baumol to all parties. Let me ask the witness a couple of questions regarding it.

DIRECT EXAMINATION

By Mr. Helmetag

Q. Would you give your name and business address for the record, please? A. My name is William J. Baumol. And my business address is Department of Economics, Princeton University, Princeton, New Jersey.

Q. And have you, sir, prepared a written statement for presentation in this proceeding which is pending before the Commission here today? A. I have.

Mr. Helmetag: Mr. Examiner, may we have the statement of William J. Baumol marked for identification as Exhibit No. 37?

Exam. Dishman: Exhibit No. 37, Respondent's.

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* * *

CROSS EXAMINATION

By Mr. Ames

Q. Dr. Baumol, I want to get on as far as I can with you, and I am going to try to avoid argument. And I yield to no one in my ignorance of cost findings. I am just going to try to ask you some questions from the standpoint of a layman. Have you ever been in the employ of a barge line? A. No, sir.

Q. Or of a railroad, that is, other than this one? A. Not except in this sort of situation.

Q. I mean from the standpoint of being a regular employee. A. No, I have not, sir.

Q. Have you ever been called upon in any capacity, whether as an economist or otherwise, to fix a freight rate on a specific commodity? A. No, sir.

Q. Have you ever had the experience of trying to urge a potential shipper to use a particular route? A. No, sir.

Q. Now, from the standpoint of the gross revenue which a railroad takes in, do we have the freight revenue, the passenger revenue or loss, credits for joint facility rents, and miscellaneous items? I am talking now about the total intake of [185] a railroad? A. Yes, sir.

Q. Have I correctly described the items? A. I don't know, sir.

Q. Well, how would you describe them? A. I am not here as an expert on the operation of railroads, I am here as an economist, and I am not prepared to give an account of the full nature of the revenues of the railroads.

Q. Well, in order to be in a sound economic condition, the railroad must take in more than it spends, mustn't it? A. Absolutely.

Q. The only thing that I am trying to develop at this point is to have you agree with me that the top figure from which you have to work is how much the railroad took in in the course of the year? A. Certainly.

Q. You could reduce that to ton mile revenue by just simply dividing the ton miles into it, couldn't you? A. The return per ton mile, yes.

Q. Now, from the standpoint of the money paid out it is also true, is it not, that that would consist of operating expenses, joint facility rent debits, taxes, interest on funded debt. Can you think of any other expenses that they have had besides those? A. I don't know, but it sounds plausible.

[186] Q. You have used in your testimony which I read last night the term "incremental expense." And again calling your attention to my ignorance of accounting methods, can I regard that as synonymous with out-of-pocket so-called? A. It is, for all practical purposes, synonymous with the definition which we heard read earlier.

Q. Now, do you agree with me, Doctor, that there is a substantial difference between what you called incremental expense and the total expense incurred by a railroad? A. Yes, indeed.

Q. Could that difference be described in your judgment simply as the difference between out-of-pocket costs and full costs, avoiding the use of this term "fully distributed" which seems to be anathema to you? A. For the operation as a whole, yes. For any individual segment of traffic the distinction is not meaningful.

Q. Now, following up that simple procedure I outlined of dividing your total ton miles into your total expense of total cost, you could arrive at a figure of, say, 20 mills a ton mile if it came out that way. A. All right.

Q. Now, assuming that the president of the railroad asked you if you thought it would be sound economics to put in a rate which would only return ten mills, or ten mills below the full cost, what would you do about that, what would you [187] tell him? A. I would tell him that it may very well be extremely sound for some particular segment of traffic, and that it depends upon the circumstances, including the elasticity of demand and the incremental cost, whether or not it is sound.

Q. Now, if, following your advice, he did reduce that rate to the point where it only earns ten mills as compared with 20 mills full cost, you will agree with me, will you not, that the difference between those two figures of 10 mills must be recovered somewhere along the line? A. Certainly. This is assuming we are dealing with one particular segment of traffic.

Q. Yes. Now, if the railroad made enough of these reductions below their full costs, and approaching their bare out-of-pocket costs, they could eventually get into trouble, couldn't they, economically? A. Certainly.

Q. Now, do you agree with me that a railroad cannot possibly show a realistic profit unless the actual revenue it receives exceeds the total amount of money which it spends? A. Certainly.

Q. Would you turn to page 10 of statement, Doctor. About the middle of the page you make this statement there: "This purpose is, of course, to prevent any carrier from pricing at a level so low that its operations would not

be [188] viable, and where the sole purpose of such a non-compensatory rate is to drive out competitors." Now, let me ask you, Doctor, what do you mean in this context by the word "viable"? A. I mean precisely what you have been getting at, that the rates should be such as to permit the revenues to cover the costs of the road.

But if I may expand on this point –

Q. You certainly may. A. There are many occasions whereby refusing to provide services at a rate just slightly above incremental costs, the railroads would be making it more difficult to conver their total costs, because by taking on traffic whose total yield, that is, whose incremental yield is greater than its incremental cost, it adds that much to the net contribution to profits as constant or overhead costs.

Q. You will agree, will you not, that you can't carry this out-of-pocket cost theory too far, if you get too much of your traffic out-of-pocket you are in trouble, aren't you? A. No, on the contrary, I would say that if you do not follow it in an appropriate manner, taking again appropriate account of elasticity demand, you are refusing to earn maximum profits, and if maximum profits don't cover your total costs, then no revenues will cover your total costs.

Q. But don't you have a sinking sensation there? [189] A. Not at all, sir.

Q. If you get enough of your traffic – say you get 90 per cent of your rates – is running at a cent or two a ton above costs, out-of-pocket costs – A. Remember, we are talking about –

Q. Let me ask the question. Are you telling me that that railroad would not be in trouble? A. If we were talking about rates, and rates were set as incremental costs throughout, the roads would be in trouble. But we are not talking about rates, we are talking about floors to rates.

Q. Well, I am talking about rates, you may be talking about floors, but I am talking about rates. And we are agreed, then, aren't we, that if we have 200 rates in your total consist that are barely above out-of-pocket you are in trouble? A. That is right. Nobody is proposing to make all of them, or most of them equal –

Q. In this case because you have but one commodity? A. That is right.

Q. But you could do it one commodity at a time? A. Certainly.

Q. And as long as you had that one commodity you would still be all right in your judgment? A. You could be, yes.

Q. Now, by the term "non-compensatory" used in that quotation – [190] do you want me to read it again? A. No, I am familiar with the quotation.

Q. Do you mean there that it would be non-compensatory for the railroads to establish a rate below out-of-pocket costs? A. That is right.

Q. Even though it is only one commodity involved? A. That is right, because the road would then be putting out more money for that purpose than it takes in.

Q. Couldn't we be like Woolworth and take a small loss but get a big volume? A. It doesn't work that way.

Q. Now, I don't know whether you have seen this exhibit of Mr. Rozaitis, Exhibit 24, which carries an explanatory statement of Form C? A. No, I have not seen it.

Q. Under the summary schedule section there –

Mr. Helmetag, will you show him where it is.

Mr. Helmetag: Yes, I will.

Mr. Ames: It is page 1 of the exhibit, on the right-hand side, under "Summary Schedule," this statement appears: "In the absence of studies showing the actual portion which out-of-pocket expenses are of total barge expenses, the operating expenses" – meaning barge expenses – "are treated in this form in effect as though they were a hundred per cent out-of- [191] pocket."

By Mr. Ames

Q. Would you keep that statement in mind, please, for the purpose of this question? A. Yes, sir.

Q. Now, inasmuch as the out-of-pocket costs for water carriers are generally regarded as a hundred per cent of their cost of doing business, whereas, out-of-pocket costs on the rail side depend upon the purpose for which they were sub-

mitted, those out-of-pocket rail costs range from 50 per cent to 80 per cent of total costs. Would you regard, then, the out-of-pocket cost equation for each type of carrier, both water and rail, as a fair basis of comparison? A. No, sir; because there is no – these are arbitrary figures to a large extent – for example, the one that you read to me – and I see no reason why you should be able to compare arbitrarily constructed figures and get some meaningful conclusions from them.

Q. Now, having in mind your theory of pricing and my theory of rates, which to me mean the same thing, I want to give you a hypothetical case and ask you how you feel about it.

Molasses is shipped in great quantities from New Orleans to northern destinations. To Peking, Illinois, it is around 900 miles, and there is keen water competition on that movement, and the rate is – we will put it as $10 a ton. To Wichita, Kansas, as a typical interior point where they use [192] molasses to make cattle feeds, the distant is still 900 miles, but the rate is $20 a ton. Now, having in mind the fact that there is competition at one point with water, and no water competition at the other point, under your theory, I take it, it would be perfectly proper to put in that $10 rate to Peking, Illinois? A. It would be proper. It isn't necessary.

Q. It would be good costing, good economics? A. No, I am not arguing that rates should be equal to incremental costs, I have argued that rates have to be no lower than incremental costs, and the fact that rates in some cases approach incremental costs may be desirable both from the point of view of the area and the point of view of the economy.

Q. I think we are going together so far. Let's assume that the all-rail costs for both 900-mile movements, that to Peking and to Wichita, are $9. To Peking they put in a rate of $10, one dollar over, and to Wichita they put in a rate of $20, $11 over. Now, in your concept of pricing I take it that that would be perfectly all right. A. Yes, sir. In

fact, I would argue that the fact that some freight is shipped at a lower cost may be of advantage to the shippers on the higher cost line, because by making a contribution to profits and overhead on the lower cost line they are making it cheaper for the others to help cover the total costs of the railroad.

[193] Q. You would have a right hard time selling that to the Wichita man, wouldn't you? A. No, not if he knows that if the other traffic were lost he would have to pay $15.

Q. Now, Doctor, in this case that we have under trial here today the record will show that the present rate on ingot molds from Neville Island to Steelton is $11.86 per gross ton all rail. The proposed rate is $5.11 per gross ton, or $6.75 lower. Now, the present all rail rate of $11.86 compares quite favorably with other all-rail rates, there is an exhibit in this case which makes that comparison. Under your concept of pricing or rate-making would you say that both of those rates would be all right, could be all right? A. They could be.

Q. It wouldn't occur to you, would it, that if out-of-pocket costs are a fair criteria that may be they were charging this fellow a little too much under the present rate? A. It is conceivable. I just don't know. I have not argued to begin with that out-of-pocket costs should be equated to rates.

Q. In your concept of competitive rate-making would you regard costs as the only real dependable criterion? A. No, sir.

Q. What others would you use? A. Elasticity of demand in particular.

[194] Q. But you have to bottom them all on costs as a starting point, do you not? A. Yes.

Q. Is it possible in your judgment to determine the true costs of handling one specific commodity from one origin to one destination? A. It is possible in principle to determine the incremental cost of carrying one commodity. It is not possible in principle to determine the full cost, because that involves arbitrary apportionments of overheads joint costs and a variety of other costs.

Q. The only way you can assign incremental costs to that specific movement is to take your average incremental costs and apply it to that movement, isn't it? A. No, sir; that is not how I would go about it.

Q. You mean you would get on a locomotive and study a movement of ingot molds from – A. I would certainly examine engineering, statistical costs, accounting data, and try to deduce data for that particular movement, and try to determine from those data what difference it made to the cost of that particular operation to increase its level, or to decrease it. I would not guess at them from an average of other movements.

Q. You have got me at the foot of the class now. One of the railroad cost witnesses in this case made the statement that it [195] is impossible to determine the true cost of handling any specific commodity, and I believe the Courts have held that. Do you disagree with that? A. It depends on what you mean by true costs, first of all, whether you are talking about true full costs, true incremental costs, true total costs.

Q. We will talk first about incremental costs. A. It is possible in principle to find the true incremental costs. In practice you can approximate it fairly well in some circumstances.

Q. In practice if you did indulge in the practice you would have to actually study that individual movement? A. Right, absolutely.

Q. And so far as you know there has been no study here? A. I don't know.

Q. Now, again from the standpoint of what you regard as appropriate pricing concepts, I want to ask you another hypothetical question. I am visualizing a railroad train, and on that train there is a car containing 40,000 pounds of lumber, wire nails, or what have you, and right back of it there is a car containing 40,000 pounds of transistor radios, much more valuable. The two are coupled with the coupling pin usually used on a railroad, and by the same locomotive, are going to the same destination, from the same origin. You

are not making the point here, are you, that the out-of-pocket [196] cost or the incremental cost in handling to cars under those circumstances would be different? A. They might conceivably be because of weight, perishability and a variety of other circumstances.

Q. Wait a minute. I told you the weight was the same exactly, so get that out of that. A. If you state that they are the same, then certainly the out-of-pocket costs will be the same.

Q. I have stated that they are the same weight, from the same origin, from the same destination – A. The same degree of reliability of pilferage, same degree of perishability, the same degree of a variety of other things – it is just not obvious on the face of it that the costs need be the same.

Q. Then you do concede that there could be a difference of out-of-pocket costs on those two cars? A. Yes, there could be.

Q. At pages 3 and 4 of your statement you make this statement: "There is no question that cost data are pertinent to railroad pricing and to any regulatory decisions in this area. The type of cost figure which is appropriate for use in this decision process is clear to economists, but it seems to have been beclouded by arguments presented to the Interstate Commerce Commission on behalf of various parties." That will include me. "This exhibit undertakes to explain the conclusions of economic analysis on this matter."

[197] Do you have that paragraph in mind? A. Yes, sir.

Q. Now, again in your concept the real, crucial, basic element that you have to consider there is the out-of-pocket cost? A. Yes.

Q. When the 1958 transportation act was under consideration in Congress Chairman Freas of this Commission appeared before the Committee on Interstate and Foreign Commerce, and he was asked his opinion as to what kind of costs should govern in the fixation of freight rates on competitive traffic. And he made this statement: "When-

ever conditions permit, given transportation should return the full cost of performing carrier service. Certainly full costs in the aggregate have to be obtained in our transportation system if it is to be kept healthy. In many instances, however, the full cost of the low cost form of transportation exceeds the out-of-pocket cost of another. If, then, we are required to accept the rates of the low cost carrier merely because they exceed its out-of-pocket costs, we see no way of preserving the inherent advantages of the low cost carrier.

"In any event, that other mode would be compelled to depress its rates below full costs in order to preserve its inherent advantages against the high cost form of transportation. This would mean that the carrier with the inherent advantages would be forced into an unhealthy situation, or that higher rates [198] would have to be charged on non-competitive traffic in order to make up the deficit, for certainly the full cost of performing transportation service must come from somewhere."

Now, I know, Doctor, that you have seen that. And I know what your answer is going to be. But you tell me right now in just simple language, you disagree completely with that, don't you? A. That is right.

Q. Then we don't need to carry it any further, then.

I am correct when I say that your views and those of Chairman Freas simply could not be reconciled on that particular point? A. In general, yes.

Q. Now, I have called your attention to the fact that the present rate in this situation of $11.86 is $6.75 higher than the proposed rate. And you said you thought that could be justified, that both rates might be proper? A. They might be.

Q. Now, you weren't basing that on any physical condition or transportation condition, you were basing it on cost considerations, I take it? A. What I am saying is that I have no evidence that they are improper – not that I have positive evidence that they are proper.

Q. You have used the term "maximize the contribution" quite a good deal, Doctor.

[199] And bear me out if I am correct in assuming that by that you mean the portion of the rate as above the incremental or out-of-pocket costs, is a contribution to net, so to speak. A. Yes.

Q. And in your judgment a rate could not be destructively competitive unless one, the railroads put in a rate below the incremental cost, or two, whether they put it in for the purpose of driving out a competitor. A. I take it your question is –

Q. You say that in here somewhere. A. I am just a little puzzled by the construction of that question. But I take it you are saying – you are attributing to me the view that a rate cannot be destructive unless it is below incremental cost, and it is intended to drive out competitors?

Q. Right. A. I agree.

Q. Well, how would you know whether they intended to get that result? They would probably say that they never intended any such thing. A. Well, that would still prevent the rate from being below incremental cost.

Q. Then they would only have to have one, out-of-pocket cost. A. To prevent it, certainly.

[200] Q. On this out-of-pocket pricing, it is very easy to price an individual movement if you can just utilize that movement and consider it in a vacuum. But in your studies or in your thoughts on this subject, do you agree that you would have to give some consideration from the economic standpoint to the question whether that reduction would cause a downward spiral in other rates? Did you in your approach to this give that matter any consideration at all? A. Certainly in general one considers this, yes.

Q. You would have to as the manager of a railroad, would you not, take that into account? A. Yes.

Q. And I take it that when you used the term "profit" in your treatise here you had reference to maximizing the contribution? A. Yes.

Q. In other words, you didn't, when using the word "profits," you didn't jump above the full cost plateau, you didn't get up in there at all, did you? A. No. The full

cost – presumably some of the contributions, if they are sufficiently large, will make a net profit in the sense of more than covering full costs.

Q. I don't know that we are together yet. Would you agree with me that when you use the word "profit" in this statement that we can regard it as synonymous with a contribution to overhead? [201] A. Well, an increment to profit is an increment to the payment of overhead. It is total profit for some of those increments which can then be compared to total cost.

Q. Now, on page 13 you make this statement, Doctor: "It is impossible to implement a policy calling for rate regulation on the basis of the costs of 'the low cost carrier', because there is no valid procedure which can identify the carrier whose operating costs are lowest."

I am a little baffled by that. Do you mean that it is impossible where the competition is between a rail carrier and a water carrier to determine their respective costs. A. On a comparable basis, yes.

Q. Why do you say that? A. Particularly if you are dealing with full costs, because these involve arbitrary allocations and apportionments of the overhead burden.

Q. I am not talking particularly of full costs, I am saying to you, are you making the point here that it is impossible to determine the incremental or out-of-pocket costs of the respective carriers. A. It is impossible because you have to get the relevant comparable incremental costs. You would have to take account, for example of public costs.

But from the point of view of society, the relevant comparable costs are the relative usages of the nation's resources [202] and the nations resources include both public as well as private resources.

Q. The point you are making there in that sentence I believe I understand now, that there can be no proper basis of comparison because on the water side of the equation no account is taken of public costs such as dredging? A. Yes.

Q. And this is why you made that statement then, am I correct in that? A. Yes.

Q. Now, as a practical business proposition as it is used in the higher level of economics, when you say something costs a man something, don't you have in mind what he is paying out? A. Yes. But if we are talking about public policy we have to take into account much more than what that man is paying out.

Q. Well, it is real cost to him is what he pays out, isn't it? A. But the basis for public policy in rate making is not just what he pays out.

Q. I understand your position there. But I still say that the water carriers cost is out of his pocketbook, or what he pays out of his pocketbook? A. Yes, certainly.

Q. I am trying to think whether I should ask you this question or not. In the back here you have a little pamphlet called [203] "The Role of Costs in the Minimum Pricing of Railroad Services," and that includes your name among quite a number of economists there, including Ford Edwards? A. That is right, sir.

Q. Was that contribution made by these various gentlemen without any compensation at all, just as a public service? A. No, sir.

Q. Was it paid for by the railroad? A. Yes, it was.

Q. Then you and I are objective with each other, aren't we? A. Yes.

Mr. Ames: That is all I have.

Mr. Helmetag: I just want to ask two questions on redirect.

REDIRECT EXAMINATION

By Mr. Helmetag

Q. Referring to page 13 of your statement, Mr. Baumol, you talk about the difficulty of comparing the cost of different agencies. One of the factors that contribute to that difficulty is the fact that the different agencies may provide a different quantum of service, isn't it? A. Absolutely.

Q. Is that what you meant when you talked about the vast structural dissimilarities? A. Yes. This is certainly an important component. The answer to the question

I was asked I took to mean whether it was [204] possible in principle to compare incremental costs of one carrier with another. My statement addresses itself to the practical difficulties of comparison of incremental costs of one carrier with another. There is just no question that the accounting difficulties, that the complications arising from the services provided by different agencies, make it for all practical purposes impossible to get a comparison in practice between the incremental costs of different carriers.

Q. You didn't mean to infer, did you, sir, that you couldn't compute the incremental costs of one agency and also compute the incremental costs of another? A. No, sir.

Q. But when you try to compare the two the difficulty arises, is that right? A. That is right.

Q. I think this is clear in your statement, but there is no question in your mind about this, is there, that a reduction in rates can be made whereby the amount per unit above the incremental cost is lower as a result of the reduction, and still the carrier will be better off, there are situations where that occurs, isn't that right. A. There is no question. If you were formerly making a net of $2 a piece on a hundred tons, and you then reduce rates so that you make a net of one dollar a piece on 10,000 tons, you are clearly ahead.

[205] Q. Mr. Ames asked you one question about the rate that was intended to drive a carrier out of business. Is it your statement that that would be a destructive competitive practice? A. It depends upon whether you are talking of legal definitions, because I am in no position to comment on legal definitions.

Q. But this much you have no question about, that if the rate is below the properly calucated incremental cost, it is destructive competitively? A. Certainly its effect may be destructive.

Mr. Helmetag: I have nothing further.

Exam. Dishman: Do you want to offer the exhibit?

Mr. Helmetag: Yes. I just wanted to be sure that Mr. Ames didn't have another question.

Exam. Dishman: You offer it in evidence?

Mr. Helmetag: Yes, sir.

Mr. Ames: I have no objection.

Exam. Dishman: It is received in evidence.

(Respondent's Exhibit No. 37, Witness Baumol, was received in evidence.)

Exam. Dishman: And the witness is excused.

(Witness excused.)

Mr. Leigh: Mr. Examiner, might I call attention to a problem that we had here. Dr. Edwards has illness in his family and he is quite anxious to go back home just as soon [206] as he can. I have distributed a copy of Dr. Edwards' prepared testimony, I haven't yet handed it to the bench. I wonder if I could call him and have it qualified and have this statement marked as an exhibit, and then have Dr. Edwards return some other time for cross-examination, if cross-examination is desired.

Exam. Dishman: Is that agreeable, Mr. Ames?

Mr. Ames: I am agreeable to putting him on and having him identify the exhibit.

If we could go off the record a moment I might be able to suggest something that would help us all out.

Exam Dishman: All right, off the record.

(Discussion off the record.)

Exam. Dishman: On the record.

Mr. Leigh: I will call Mr. Edwards.

FORD K. EDWARDS

was duly sworn and testified as follows:

DIRECT EXAMINATION

By Mr. Leigh

Q. Please state your name and address? A. My name is Ford K. Edwards; address, 1111 "E" Street, Northwest, Washington, D. C.

Q. Dr. Edwards, have you prepared a statement to be introduced or offered in evidence in this proceeding relating to the economic theories involved in costing? A. I have.

[207] Mr. Leigh: Mr. Examiner, may we have the statement of Ford K. Edwards marked for identification?

Exam. Dishman: As Respondent's Exhibit No. 38.

(Respondent's Exhibit No. 38, Witness Edwards, was marked for identification.)

By Mr. Leigh

Q. Dr. Edwards, you heard Dr. Baumol's testimony—you have read his testimony as well as heard his cross-examination this morning? A. I have.

Q. And are you in agreement in principle with the testimony Dr. Baumol gave? A. I am.

Mr. Leigh: No further questions.

CROSS-EXAMINATION

By Mr. Ames

Q. I can only ask you, Doctor, whether the language – the language I know is different – but have you made any points over and above those made by Dr. Baumol? A. I have dealt with the same points, with illustrations that I thought would clarify it.

Q. But you would come out the same way? A. I would come out the same way, yes.

Q. And you would be willing to adopt his testimony? A. I would.

Q. Now, when did you leave the Commission, Dr. Edwards? A. In 1949.

[208] Mr. Ames: If the other side will agree with me, Mr. Examiner, that both of these statements are in support of the proposition that the fully distributed costs – that the out-of-pocket or incremental costs must be the governing factor in rate making, to the disregard of the fully distributed costs, or the full costs, if you want to put it that way, and Dr. Edwards will say that he would answer me the same way that Mr. Baumol answered me, from the standpoint of conserving time I am willing to excuse him. I do believe that if I get an opportunity sometime today to read this – I don't believe I really need that.

If you are willing to make the stipulation I have just outlined, I will waive the reading of it.

Mr. Leigh: We will so stipulate – unless Dr. Edwards has a statement to make.

The Witness: Yes. I would like to point out that on page 29 of my statement I made the observation that the proposed rate compares with the out-of-pocket costs introduced by the respective Pennsylvania and L & N cost witnesses, and that the margin of the rate over out-of-pocket costs is 9 per cent. I have taken it one step beyond that and stated that in my judgment those out-of-pocket costs would be excessive to the degree that they include an allowance for the return on the roadway property, the position being that the addition of this traffic would have no influence upon the roadway plant itself, primarily [209] the trackage, and that in arriving at the out-of-pocket or incremental costs of these two railroads to handle this traffic, the allowance is for return and on trackage would not be an incremental cost. And I have indicated the effect of excluding that, in which case the proposed rates would exceed the out-of-pocket cost, excluding road return, by 20 per cent.

Q. (By Mr. Ames): In that position you are in conflict with Form A as it presently is in force? A. No, Rail Form A provides that if there is no addition to road that factor may be included or excluded. That is in the basic instructions of the formula itself, that alternative is left open.

Q. You mean the accountant or the manager of the railroad can determine in his own mind whether the return on road property is germane? A. No, I mean by that that the analyst in applying the costs would make inquiry into that subject, whether the addition of this traffic would cause an expansion in the plant. I pointed out that the formula leaves that subject open as an alternative.

Q. I see. A. That is all.

Mr. Ames: Well, is the stipulation on the record, Mr. Examiner?

Mr. Helmetag: Mr. Examiner, there is only one question I have about the stipulation, and I think it is really one for [210] clarity and clarification. We are talking about the incremental costs in this proceeding as providing the cost floor for rates – they are the determining factor as to what the floor should be under the rates. We are not saying, as Dr. Baumol pointed out, that the rates should be fixed at the incremental level, they can vary upward from it, but we are talking about what is the relevant cost floor to be established by the Commission, and we say that in that area the incremental costs are determinative. That is the point we are making.

Mr. Ames: Well, when you speak of the floor of a railroad rate, and you isolate it, or treat it as though it were in a vacuum, then it becomes merely the question of the quantum of the rate. Our position here is that you have an intermodal competitive factor that you have to consider.

Mr. Helmetag: That is right.

Mr. Ames: And the question here is whether in that competitive posture you must consider the full cost rather than the out-of-pocket. Now, both of these expense witnesses have advocated that in that case you should only consider the out-of-pocket.

Mr. Helmetag: That is right, I agree with you.

Mr. Ames: And I take it that there is going to be no deviation from that.

Mr. Helmetag: None whatsoever. But what I am saying is that your reference to out-of-pocket costs as contrasted with [211] the fully distributed or full cost is to determine the floor for the rates. That is the point we are making.

Mr. Ames: There again I think when you use the term "floor" you are talking about isolation.

Mr. Helmetag: No, I am not talking about isolation, I am talking about the floor, not only absolutely, but the floor in these competitive situations, that should provide the floor in these competitive situations we are talking about.

Exam. Dishman: Is that satisfactory, Mr. Ames?

Mr. Ames: I have nothing further.

Exam. Dishman: Is the record satisfactory on this stipulation?

Mr. Ames: I think so. Of course, I take it most of that was on the record. Sometimes we are off.

Exam. Dishman: It was all on the record after Dr. Edwards took the stand.

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DELBERT M. STEINER (recalled)

[213] * * *

Q. Now, on this question, Mr. Steiner, which Dr. Baumol testified, [214] disregarding the fully distributed costs, let me ask you this question. If you could isolate the particular rate situation entirely from the standpoint of constant costs, that is, consider only constant costs, and you could do that in relation to the movement of one commodity, couldn't you do it with the other commodities one by one? A. You are talking about the isolation of constant costs rather than variable costs, are you?

Q. Yes. A. In the matter of isolation of costs for a particular commodity movement you could take each one of them individually, and you could determine individually what the margin would be.

Q. And you would rationalize your action by arguing that you were only considering rates on one commodity? A. Yes sir.

Q. Now, one of the exhibits in this case, introduced by the Witness Rogers, shows that about 85 per cent of the total barge line tonnage is in 10 commodity descriptions. Well, following out that reasoning, you could repeat this 10 times and you would do the trick, wouldn't you, of getting the barge lines out of business? A. Well, if you set the rates at such a level that they couldn't compete for 10 commodities it would have a lot of impact on movement by barge.

Q. Even assuming for the sake of argument that in this case [215] the railroads would be better off with this proposed rate than without it – I am just asking you to assume that – don't you think it is proper also for the Commission to consider the effect of the rate on competitive modes of transportation? A. Yes, sir.

Q. Now, it is true, is it not, Mr. Steiner, that in the application of the barge line cost formula that the so-called out-of-pocket costs for barge lines is generally regarded as the full cost, exclusive of the return on investment? A. I think the term used is that it is treated as though it were 100 per cent variable.

Q. And the only way that the barge line has to expand that into what we might call full costs or fully distributed costs is to either add something for a four per cent return on investment or apply an operating ratio to it? A. This is what is suggested in the barge Form C.

Q. Now, after hearing Dr. Baumol testify do you have any comment to make on his presentation? A. Nothing in specific, sir, no.

Mr. Ames: That is all I have, sir.

Mr. Helmetag: Could I ask just a few questions on recross-examination, sir?

RECROSS-EXAMINATION

By Mr. Helmetag

Q. With respect to the barge lines, the [216] reason why the expenses are regarded as a hundred per cent variable is because the barge lines have no substantial investment in permanent facilities, isn't that the explanation for that? A. As I read the barge formula – and this is as much as I know about it – it indicated that no study had been made to determine the variable.

Q. But isn't that the practical situation, that the barge lines have no substantial investment in what might be called a permanent or virtually permanent facility? For example, let me give you this. Their barges that they have, they can add or subtract barges according to the amount of traffic that they have, isn't that the situation? A. Well, over a period of time they obviously could.

Q. In other words, if the traffic were to increase 10 per cent, if there is a likelihood that it would increase 10 per cent over 10 years, they could add 10 per cent more barges to take care of it, isn't that a fact? A. Well, that is true of any means of transportation as to equipment.

Q. That is true. And in the Rail Form A the equipment is treated as a hundred per cent variable, isn't that right? A. Yes sir.

Q. And the reason why the railroads have a substantial percentage of constant costs is because they have large [217] investments in facilities which are either permanent in nature or virtually permanent, such things as bridges, the roadway, the tracks, and that type of thing, isn't that true? A. I don't believe that accounts for the total amount of constant costs or the vast majority of constant costs.

Q. Well, it accounts for a substantial amount of it, isn't that so? A. It accounts for some of it.

Q. Because with respect to the 80 per cent that is used in the Rail Form A, that is based on a composit of percentages, treating the equipment as a hundred per cent variable and some of the other items as less than a hundred per cent variable, isn't it? A. No, the 80 per cent is not arrived at in that manner.

Q. Wasn't that the basis for the 80 per cent variable? A. No sir.

Q. You say that is not the fact? A. No, sir. The hundred per cent variability of equipment relates only to the return on investment, or the variability of investment. The 50 per cent variability of equipment relates to the investment, and the hundred per cent variability – excuse me – the hundred percent variability of investment and the 50 per cent variability of road relates to investment, not to operating expenses.

Q. Now, when the Commission cost section made the composit 80 [218] per cent ratio as representing the portion of the total expenses which are variable, didn't they base that on studies which treated some expense items as being a hundred per cent variable, and others being 50 per cent variable and some being 75, and that type of thing, and that the 80

per cent represents a composit of all these variability percentages? A. You have two things that you have put together to a conclusion that may or may not be right. You are thinking of back in 28,300, in which at that time each individual account item was given a per cent variable. In 28,300, if I remember the figures correctly, it came up with something like 76 per cent variable. When they came to the 80 per cent they were attempting to get at the same type of figure, but they did not work out all of the detail of individual accounts, they were analyzing aggregate expenses and the variability of aggregate expenses under varying conditions.

Q. It represents the business judgment of the Commission's cost section, based on a composite of the varying percentages that the various expense accounts are variable, isn't that right? A. No, it was the composite opinion of the Cost Section or the judgment of the Cost Section as to how the total expenses were variable, without looking at individual expenses separately.

Q. But when the original studies and formula were in process, it was the thinking of the Cost Section that various expense [219] items had different percentages of variability, isn't that so? A. In the original 28,300 investigation.

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[220]

Mr. Examiner, we had a stipulation with Mr. Ames this morning to the effect that if Dr. Buchanan were asked the same questions as Dr. Baumol on cross-examination his answers would be substantially the same because his testimony relates to the same basic economic principle, namely, the use of incremental costs as the floor for reduced rail rates.

Is that satisfactory, Mr. Ames?

Mr Ames: Yes.

Exam. Dishman: Will you make that stipulation in regard to this witness?

[221] Mr. Helmetag: Yes, sir.

Mr. Ames: The same stipulation will be made as we had as to Dr. Edwards.

Exam. Dishman: Is there any question at all, then?

Mr. Ames: No.

Exam. Dishman: Do you offer the exhibit?

Mr. Helmetag: I offer Exhibit 39 into evidence.

Exam. Dishman: It is received in evidence.

(Respondent's Exhibit No. 39, Witness Buchanan, was received in evidence.)

Exam. Dishman: And the witness is excused.

(Witness excused.)

Mr. Helmetag: While I am here, in the interest of orderly procedure, I would like to have identified as Respondent's Exhibit No. 40 the statement of Dr. Richard B. Heflebower of Northwestern University which was circulated last night.

Exam. Dishman: That will be identified as Respondent's Exhibit No. 40.

(Respondent's Exhibit No. 40, was marked for identification).

Mr. Helmetag: Mr. Examiner, Exhibit No. 40 for identification, it is my understanding that Mr. Ames is willing to make the same stipulation with respect to it and have it admitted into evidence even though the witness, Dr. Heflebower, is not physically present. He could have been here tomorrow, and was prepared to be here, but to avoid having him come on, [222] I understand the stipulation will apply to him, and that the statement will be admitted into evidence even though the witness is not physically present.

Is that agreeable, Mr. Ames?

Mr. Ames: It is satisfactory to me.

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